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Exhibit Number	:	DRA-1
Commissioner	:	Mark Ferron
Admin. Law Judge	:	Richard Clark
DRA Project Coordinator	:	Robert Levin
DRA Witnesses	:	Robert Levin, Elise Torres

DIVISION OF RATEPAYER ADVOCATES
CALIFORNIA PUBLIC UTILITIES COMMISSION

TESTIMONY ON PACIFIC GAS AND ELECTRIC'S ECONOMIC DEVELOPMENT RATE PROPOSAL

A.12-03-001

San Francisco, California
August 24, 2012

TABLE OF CONTENTS

MEMORANDUM

This report was prepared by the Division of Ratepayer Advocates ("DRA") of the California Public Utilities Commission ("Commission") in Pacific Gas and Electric's Application for an Economic Development Rate ("EDR") for 2013-2017, filed March 1, 2012. In this docket, the applicant requests that the Commission approve a Standard Option EDR with a 5-year, 12% discount, available to qualifying Large Commercial and Industrial customers everywhere in its service area, and an Enhanced Option EDR with a 5-year, 35% discount, available only in counties with unemployment rates of at least 125% of the State's average.

In this report DRA presents its analysis and recommendations on EDR rate design, funding, and customer eligibility requirements. DRA recommends that PG&E's request for a new Standard Option EDR with a 12% discount be granted with modifications, but that its proposed 35% discount Enhanced Option be modified to start at 35% and decline to 10% over 5 years. DRA also recommends tightened eligibility requirements, retention of a pricing floor on discounts, and that all EDR contracts be required to have a positive contribution to margin over the contract term. Finally, DRA recommends that PG&E shareholders fund a portion of the cost of discounts, as well as any negative contribution to margin remaining after 10 years from the inception of the first EDR contract under the new program.

Robert Levin served as DRA's project coordinator in this review, and is responsible for the overall coordination in the preparation of this report. Chris Danforth is the Interim Program Manager who oversaw this project and the review of this report.

DRA's witnesses' prepared qualifications and testimony are contained in Appendix A of this report. Appendix B contains DRA's responses to the questions posed in the August 7, 2012 Assigned Commissioner's Scoping Ruling.

EXECUTIVE SUMMARY: ECONOMIC DEVELOPMENT RATES

(Witnesses - Robert Levin and Elise Torres)

I. INTRODUCTION AND SUMMARY

DRA supports the goals of enhancing California's competitiveness and increasing the number and quality of jobs available to California residents. PG&E has proposed new Economic Development Rates ("EDR") intended to achieve these goals. DRA finds that PG&E has correctly identified a need for a new EDR program, with changes from the current EDR, to meet the goals stated above. Unfortunately, DRA cannot support PG&E's EDR proposals, without major modifications, because they create unacceptable risks for ratepayers. PG&E has proposed numerous and major departures from the ratepayer protections incorporated in the current, expiring EDR framework. PG&E's proposals, if adopted, could harm, rather than benefit, ratepayers. However DRA offers its own version of PG&E's proposed Standard and Enhanced EDR Options, intended to help eligible "at risk" businesses maintain and expand job opportunities in California while providing reasonable assurance of ratepayer benefits.

If carefully crafted and appropriately applied, an EDR program can benefit ratepayers while providing a tool, among other tools, to support a stronger business climate in California. An EDR, however, involves risks, as well as rewards, for ratepayers. Indeed, compliance with P.U. Code Section 740.4 (h) makes it incumbent upon the Commission to include appropriate ratepayer safeguards intended to ensure that the benefits of EDR outweigh the risks.[1] Accordingly, the Commission must bear in mind that California's electric rates are already among the highest in the Nation. Without proper safeguards, an EDR program can increase rates to nonparticipating ratepayers, and potentially do more harm than good. A quote from D.05-09-018 is equally applicable today:

[1] P.U. Code Section 740 (h) requires that "the ratepayers of the public utility derive a benefit" from an economic development rate.

> *"The adoption of this EDR should also be viewed as a stopgap measure to address a small part of the harmful impacts the current rate levels have on California's economy and the state's potential for economic growth and development. ......However, the need for this EDR serves as a flashing warning light that we must continue to take all steps necessary to address the level of rates in California."*

In its current application, PG&E requests authority "to establish an Economic Development Rate (EDR) that is specifically tailored to address varying economic conditions in the Company's service area." In addition to retaining the "Standard" 5-year, 12% discount EDR option, PG&E proposes to create a new "Enhanced" EDR option in counties where the annual unemployment rate for the previous calendar year was at least 125% of the state annual average. The Enhanced EDR Option would provide a 5-year, 35% reduction of an eligible customer's otherwise applicable tariff[2].

PG&E's EDR proposals are summarized and compared with the current EDR program in Table ES-1. Tables ES-2 and ES-3 present a similar comparison (DRA's EDR proposals vs. the current EDR).

The issue of adequate ratepayer safeguards is a key concern raised by PG&E's new EDR proposals, which would jettison many of the ratepayer safeguards built into the current EDR program. Chief among current safeguards is a floor price, which consists of the sum of marginal costs and nonbypassable charges ("NBCs"). The floor price serves to ensure that nonbypassable rate components are not discounted and that the marginal costs of serving participating customers' demands are not shifted to other customers. PG&E now proposes to eliminate the floor prices, along with other safeguards such as third-party oversight of customer eligibility for EDR, vital features of the customer affidavits, and critical elements of the EDR contracts.

[2] In both EDR options, the discounts would apply to the applicable tariff rate excluding taxes.

Table ES-1: Current EDR vs. PG&E's Proposals

Current EDR	**PG&E Proposal**
Standard 12% Discount, 5-year term	Standard 12% Discount, 5-year term
No enhanced discount option	Enhanced 35% discount in high unemployment counties, 5-year term
<u>Additive</u> floor price based on Marginal cost + NBC Rate Components, enforced annually, ex ante & ex post	No floor price
CTM cannot be negative in any year	CTM can be negative over contract term
Annual ex post back billing to recover negative CTM from EDR customer	No ex post recovery from EDR customer
Distribution constrained by marginal cost floor	Negative distribution rates allowed
Generation constrained by marginal cost floor	Generation not discounted
No discounting of NBC Rate Components (including Transmission)	NBC rate components are effectively discounted in some cases, via negative distribution charges
No PG&E shareholder participation	No PG&E shareholder participation
200 MW cap	No cap
• Approval of applicants by CalBIS required; • limit participation to customers whose energy costs are at least 5% of operating costs, • implement with an affidavit provision; • requires PG&E to conduct energy audit of the applicant's facility & discuss cost effective EE/ demand side management measures with applicant.	• No third party oversight required. • implement with an affidavit provision without the provision verifying that energy costs are at least 5% of operating costs; • requires PG&E to conduct energy audit of the applicant's facility & discuss cost effective EE/ demand side management measures with applicant.
Assignment of Contracts permissible only if PG&E consents in writing and the party to whom the agreement is assigned agrees in writing to be bound by the EDR agreement in all respects	Assignment of Contracts permissible only if PG&E consents in writing and the party to whom the agreement is assigned agrees in writing to be bound by the EDR agreement in all respects
EDR contracts can be renewed for one additional 5-year term.	Standard and enhanced EDR contracts can be renewed for one additional 5-year term.
Liquidated damages clause for customer fraud or misrepresentation	Liquidated damages clause for customer fraud or misrepresentation

PG&E's rationale for the elimination of floor prices notes that the resulting "significantly smaller available discount made it difficult or impossible to offer a customer a sufficiently meaningful incentive to sway the location decision." DRA agrees that application of the current floor price did not enable PG&E to provide the full 12% discount otherwise allowed by the EDR program. However, DRA strongly disagrees with PG&E's proposed remedy, which is the complete elimination of a price floor for EDR contracts. DRA believes that a price floor is a necessary ratepayer safeguard, and discusses proposals for modifying the existing price floor to allow for meaningful discounts when warranted, while still protecting ratepayers from cost shifting.

Existing ratepayers benefit from PG&E's acquisition of new customers, or retention of existing "at risk" customers, as long as the revenue provided exceeds the incremental cost (or marginal cost) of service. Therefore, "ratepayer benefit" is measured by the excess of the revenue provided by the new or retained customer above the marginal cost. This quantity is often termed "contribution to margin," or CTM. Thus, a marginal cost-based floor price is needed to ensure a positive CTM, and thereby provide ratepayer benefit.

Lacking a price floor, PG&E's EDR proposals would result, in some instances, in a negative CTM over the proposed 5-year contract term[3]. DRA believes that such an outcome would violate the provisions of P.U. Code 740.4(h). While PG&E cites the benefits of job retention and job creation, DRA questions whether those benefits would fall in the purview of "ratepayer benefits" as that term is used in P.U. Code 740.4(h), and thus, whether such benefits can offset a negative CTM.

DRA also takes issue with PG&E's proposal to design its Enhanced EDR Option as a 35% discount in each year of the 5-year contract term. Not only would a 5-year 35% discount would violate DRA's modified floor price proposal; it would result in a

[3] PG&E's testimony asserts that, in all cases, the net present value of CTM would be positive in 10 years, under the assumption that the customer pays the full tariff rate after contract year 5. This is a rather strong assumption: there is nothing that would prevent a customer from leaving the State after 5 years, or seeking a second 5-year EDR contract; either action could result in a negative 10-year CTM if the initial

(continued on next page)

nearly 50% rate increase if the customer returns to full tariff after the 5-year EDR contract term. To mitigate these effects, DRA proposes a declining discount for eligible customers in high-unemployment counties, beginning with a 35% discount in contract year 1 and declining to 30%, 20%, 15%, and 10% in contract years 2-5, respectively. DRA's proposal is roughly equivalent to a 22% discount over 5 years, and, in most instances, would be allowed by DRA's proposed modified floor prices.

In summary, DRA believes that a carefully crafted EDR program can be beneficial and supports a modified version of PG&E's EDR proposals. DRA's proposal includes a declining Enhanced EDR discount, a modified floor price, continued third-party oversight, and appropriate participation by PG&E shareholders. DRA's recommendations are summarized in the next section.

II. SUMMARY OF DRA RECOMMENDATIONS

DRA recommends the following:

1. A Standard Option EDR program with a 12% discount over a 5-year contract term should be available everywhere in PG&E's service territory, to bundled service, direct access ("DA"), and Community Choice Aggregation ("CCA") customers, subject to pricing floors which may limit the available discount in a few cases.

2. An Enhanced Option EDR program offering a declining discount starting at 35% should be available in counties with unemployment rates of more than 125% of the statewide average. The discount would decline to 30% in year 2, then to 20%, 15%, and 10% in years 3, 4, and 5, respectively. Available discounts to DA and CCA customers may be limited by price floors.

3. All EDR contracts should be required to demonstrate a positive contribution to margin ("CTM") over the 5-year contract term on an ex ante (forecast) basis.[4] The following should be included in the marginal cost used to calculate the CTM: (a)

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5-year CTM is negative.

[4] That is, the 5-year net present value of the contract revenue must exceed the 5-year net present value of the marginal cost to serve the customer.

marginal generation costs[5], including a 15% resource adequacy adder in the marginal generation capacity cost; (b) marginal distribution cost for constrained or unconstrained areas, as applicable; (c) the full retail transmission rate; and (d) the DWR bond charge.

4. In addition, as a separate test from #3 above, EDR contracts may not discount nonbypassable ("NBC") rate components[6].

5. As a third test, EDR discounts should be subject to a modified additive price floor applied over the 5-year contract term, but not necessarily annually. The modified additive price floor should consist of the NBC rate components, plus the marginal energy cost and the marginal distribution cost. Thus it excludes marginal generation capacity costs, which are captured separately in #3 above. The 5-year net present value of the contract revenue should exceed the 5-year net present value of the modified additive price floor.

6. Distribution rates should be discounted subject to a distribution marginal cost floor. Negative distribution rates should not be allowed.

7. Generation rates may be discounted as needed to achieve the nominal discounts recommended above, subject to the recommended 5-year marginal cost and modified additive price floors.

8. The Commission should find that PG&E's proposed 35% Enhanced Option EDR discount could result in a negative CTM over the 5-year contract term and should be rejected on that basis.

9. The Commission should adopt DRA's recommended discounted rates for Standard Option and Enhanced Option EDR customers as shown in Appendix I. CTM calculations for PG&E's and DRA's proposals are summarized in Appendix G.

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[5] DRA recommends that the 2011 GRC Phase 2 settlement marginal energy cost value be averaged with PG&E's indexed value over the 5-year contract, with a 20% weighting of the Settlement value and 80% weighting of the indexed value. DRA also recommends that this weighted average value be used to evaluate the 10-year CTMs.

[6] The following rate components may not be discounted: The retail Transmission rate components; Public Purpose Programs; Nuclear Decommissioning charges; Competition Transition Charges; New System Generation Charges; DWR Bond Charges, and Power Charge Indifference Adjustment (for DA and CCA customers).

10. The Commission should discontinue its current practice of adjusting EDR customers' bills "after the fact" to reflect unforeseen changes in marginal costs that occurred after the contract was finalized.

11. The Commission should impose a cap of 200 MW on EDR program participation.

12. PG&E's shareholders should bear 25% of the revenue shortfall due to EDR discounts, provided the Commission adopts floor prices substantially as proposed by DRA.

13. PG&E's shareholders should bear 50% of the revenue shortfall due to EDR discounts, if the Commission adopts EDR discounts without a floor price as proposed by PG&E.

14. PG&E's shareholders should bear 100% of any negative cumulative CTM resulting from PG&E's EDR portfolio after 10 years from the inception of the first post-2012 EDR contract.[7]

15. PG&E should track annual CTM by EDR contract and for the total EDR program, in a balancing account or memorandum account created for that purpose[8]. If cumulative EDR portfolio CTM becomes negative, after 5 years (i.e., in 2018) due to unforeseen changes in the marginal costs, then the amount of negative CTM should be credited to ratepayers. Should portfolio CTM turn positive in years 6 through 10, any such credits should be reversed, so that shareholder would made whole as long as the EDR portfolio has produced a positive CTM by the end of year 10 (i.e., 2022).

16. EDR customers should be required to sign a customer affidavit that includes a provision that electricity costs constitute at least 5% of the customer's operating expenses. The California Business Investment Services ("CalBIS") should review customer applications and approve them before customers are permitted to participate in the EDR program.

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[7] See Chapter 3 for more detail concerning this recommendation.
[8] The Energy Division should hold a workshop to flesh out the details of the required revenue accounting.

17. PG&E's EDR eligibility requirements should be tightened to include more protections for non-participating ratepayers. Enhanced EDR customers should be prohibited from serving two 5-year terms on the enhanced-EDR rate schedule. Enhanced and standard EDR customers should be allowed to reapply for a second 5-year term on the standard-EDR rate schedule only. The EDR customer contract should include a non-assignment clause. A liquidated damages clause should also be included in the EDR customer contract for customer initiated early termination of EDR contracts.

DRA's recommendations are compared with the current EDR program in Tables ES-2 and ES-3.

Table ES-2: Current EDR vs. DRA's Proposals: Rates and Price Floors

Current EDR	**DRA Proposal**
Standard 12% Discount, 5-year term	Standard 12% Discount, 5-year term
No enhanced discount option	Declining discount for high unemployment areas, i.e. 35%-30-20-15-10%; 5-year term
Additive floor price based on Marginal cost + NBC Rate Components, enforced annually, ex ante & ex post	**NBC Rates**: Floor price includes NBCs, including all transmission charges and DRW bond charges. Applies annually. **Modified Additive** Floor prices based on NBCs + Marginal distribution cost + Marginal energy cost; floor price applies to 5-year NPV (ex ante only). **Marginal Cost:** Floor prices based on full marginal cost including generation capacity; floor price applies to 5-year NPV (ex ante only). (Five year CTM > 0)
CTM cannot be negative in any year	Net present value of CTM must be positive over 5-year contract term
Annual ex post back billing to recover negative CTM from customer	No ex post recovery from customer
Distribution constrained by marginal cost floor	Distribution constrained by marginal cost floor
Generation constrained by marginal cost floor	Net present value of generation CTM must be positive over 5-year contract term
No discounting of NBC Rate Components (including Transmission)	No discounting of NBC Rate Components (including Transmission)
No PG&E shareholder participation	PG&E shareholders bear 25% of discount PG&E shareholders bear 100% of negative 10-year CTM
200 MW cap	200 MW cap

Table ES-3: Current EDR vs. DRA's Proposals: Eligibility and Contract Terms

Current EDR	DRA Proposal
• Approval of applicants by CalBIS required; • limit participation to customers whose energy costs are at least 5% of operating costs, • implement with an affidavit provision; • require PG&E to conduct energy audit of the applicant's facility & create a checklist of EE/ conservation measures applicable to applicant.	• Approval of applicants by CalBIS required; • limit participation to customers whose energy costs are at least 5% of operating costs, • implement with an affidavit provision; • require PG&E to conduct energy audit of the applicant's facility & create a checklist of EE/ conservation measures applicable to applicant, require audit submittal to Commission in EDR Annual Reports & reasoning for not implementing each EE/ conservation measure
Assignment of Contracts permissible only if PG&E consents in writing and the party to whom the agreement is assigned agrees in writing to be bound by the EDR agreement in all respects	Prohibit the transfer of an EDR contract if a company is sold. The purchasers of a company that was an EDR customer must reapply for the program.
EDR contracts can be renewed for one additional 5-year term.	Prohibit Enhanced EDR customers from applying for a second Enhanced EDR term. Enhanced & Standard EDR customers can reapply for a second 5-year term in the Standard EDR program
Liquidated damages clause for customer fraud or misrepresentation	Liquidated damages clause for customer fraud or misrepresentation and a separate liquidated damages clause for customer initiated early termination of EDR contract

III. DISCUSSION

A. PG&E Proposes To Remove Many Of The Ratepayer Safeguards In The Current EDR Program

PG&E proposes to eliminate the price floor provisions in the current EDR and weaken the current applicant screening and eligibility requirements. PG&E states that its proposed customer eligibility standards for the new EDR program are similar to those in the current Schedule ED. PG&E proposes that Applicants will continue to sign an affidavit, under penalty of perjury, that "but for" the EDR incentive, either on its own or in combination with a package of other economic development incentives, the customer would not have located or retained the load in the state of California. However, unlike the current Schedule ED, PG&E now seeks authority to determine EDR eligibility without prior approval by CalBIS or another third party. PG&E's proposed changes would give PG&E sole discretion over EDR eligibility, and make it easier for customers to qualify. DRA believes that these changes would increase the risk of loss to ratepayers due to free-riders, and therefore opposes the proposed changes to the eligibility requirements.

PG&E's proposed elimination of the EDR floor price amounts to "throwing out the baby with the bath water". DRA accepts that some changes to the current floor price may be warranted, and sets forth a modified floor price proposal below. However, as discussed herein, retention of a floor price is essential to meeting the statutory test of "ratepayer benefit" for an EDR program.

Table ES-1 summarizes the difference between the current EDR program and PG&E's EDR proposals.

B. DRA PROPOSES EDR PROGRAMS THAT APPROPRIATELY BALANCE BENEFITS AND RISK

DRA recognizes the need for changes to the current EDR floor prices in order to allow PG&E to provide meaningful discounts to "at risk" customers during the current economic emergency. In response to customer need, DRA proposes to replace the current additive EDR price floor[9] with a combination of three less stringent price floors:

- a nonbypassable rate floor applied annually,
- a marginal cost floor applied over the 5-year contract term, and
- a modified additive price floor, also applied over the 5-year contract term.

These pricing floors are embodied in DRA recommendation Nos. 3, 4, and 5 above, and would allow up to a 35% discount in the initial year of a 5-year contract. DRA's floor price proposals are described in greater detail in Chapter 2.

DRA notes that PG&E's proposed Enhanced EDR Option would produce negative CTM over the proposed 5-year contract term[10]. This would violate DRA's proposed marginal cost price floor. DRA also notes that PG&E proposes negative distribution

[9] The sum of the nonbypassable charges and marginal costs.

rates that would, in some cases, effectively discount NBC rate components. For these reasons, among others, DRA proposes to remedy PG&E's Enhanced EDR proposal by reducing the initial 35% discount each year over the 5-year contract term. DRA's proposed Enhanced EDR Option rates achieve a positive CTM over the 5-year contract period and avoid negative distribution rates.

Tables ES-2 and ES-3 summarizes the differences between the current EDR program and DRA's EDR proposals.

C. DRA PROPOSES THAT PG&E SHAREHOLDERS BEAR SOME OF THE RISK OF EDR-RELATED REVENUE SHORTFALL AND NEGATIVE CTM

DRA believes that its rate proposals mitigate much of the considerable risk created by PG&E's EDR proposals. However, significant risks remain, compared to the current EDR program, because the Enhanced EDR involves a larger discount and because marginal cost floor prices would no longer be enforced annually. Currently, customer bills are adjusted annually on an ex post basis to avoid negative CTM. Under PG&E's proposal, the risk of negative CTM is shifted from participating customers to nonparticipating ratepayers.

If implemented carefully, PG&E's proposals, modified as recommended by DRA, would provide benefits relative to the current EDR program. These include increased customer participation and increased CTM. Because both ratepayers and shareholders stand to benefit from a successful EDR program[11]; both should share in the increased risk needed to achieve these benefits. Accordingly, DRA recommends that shareholders be required to bear 25% of the cost of the EDR discounts.[12]

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[10] For bundled service customers located in areas with distribution constraints.

[11] As discussed above, positive CTM exerts downward pressure on rates; and sales and revenue growth exert upward pressure on stock prices.

[12] This recommendation is contingent on adoption of EDR with a floor price substantially as recommended by DRA. In the alternative, if the Commission adopts an EDR with *no* floor price as recommended by PG&E, then DRA recommends 50% PG&E shareholder participation in EDR discounts.

In addition, ratepayer benefit under Public Utilities Code ("PU Code") § 740.4(h) requires a positive CTM, as established in Chapter 1 of this Testimony. Accordingly, if the EDR program results in a negative CTM, then ratepayers will not benefit from the program and costs from the program are not eligible for rate recovery. If program costs cannot be recovered through rate recovery under PU Code § 740.4(h), then PG&E shareholders are responsible for funding the entire negative CTM. If PG&E is not able to show a ratepayer benefit from its EDR portfolio in the form of a positive CTM within 10 years from the start of the EDR program, then the Commission should require PG&E shareholders to pay for 100% of the negative CTM.

PG&E is proposing a radical change to the current EDR paradigm in this proceeding. Currently, participants pay for any negative CTM.[13] Under PG&E's proposed new paradigm, nonparticipating ratepayers would bear the cost of negative CTM. However, State law requires that PG&E shareholders, not non-participating ratepayers, pay for the negative CTM in order to assure compliance with the ratepayer benefit provision in PU Code § 740.4(h).

IV. ORGANIZATION OF TESTIMONY

Chapter	Subject	DRA Witness
1	Economic Development Rate Policy	R. Levin & E. Torres
2	EDR Discounts and Floor Prices	R. Levin
3	EDR Eligibility, Ratepayer Protection, and Funding	E. Torres

[13] Customers are back-billed, if necessary, for any increases the marginal energy cost that occur while their EDR contract is in effect.

On August 7, 2012, Assigned Commissioner Ferron issued a Scoping Ruling with questions directed at the parties. DRA's responses to these questions are attached as Appendix B. The following lists the various appendices to this testimony:

Appendix	Subject	DRA Witness
A	Witness Statements of Qualifications	R. Levin & E. Torres
B	DRA Responses to August 7, 2012 ACR Questions	R. Levin & E. Torres
C	CalBIS Qualification Form	E. Torres
D	PG&E EDR Annual Reports	E. Torres
E	Data Request Responses Cited in Testimony	E. Torres
F	Miscellaneous Documents Cited in Testimony	E. Torres
G	Contribution to Margin from PG&E and DRA Proposals	R. Levin
H	Present Value Margin Above Modified Additive Price Floor	R. Levin
I	DRA Proposed Rates and Price Floors	R. Levin

V. CONCLUSION

The EDR program has the potential to be a useful economic development tool if administered correctly. PG&E's proposed EDR program subjects nonparticipating ratepayers to an unnecessarily large amount of risk. In the following chapters, DRA proposes many changes to the EDR program that will protect ratepayers and ensure the effective and efficient administration of the EDR program.

CHAPTER 1. – ECONOMIC DEVELOPMENT RATE POLICY

(Witness - Robert Levin and Elise Torres)

I. INTRODUCTION AND SUMMARY

DRA continues to support the goals of strengthening California's economy and increasing the number and quality of jobs available to California residents, as it has in the past. Economic development rates ("EDR"), if carefully crafted and appropriately applied, can be a beneficial tool, among other tools, in support of these goals. However an EDR involves risks for ratepayers, as well as rewards, and it is incumbent upon the Commission to include appropriate ratepayer safeguards intended to ensure that the rewards outweigh the risks. DRA believes that PG&E's new EDR proposals would impose unacceptable risks on ratepayers, and must therefore be rejected as proposed. DRA would, however, support a modified version of PG&E's EDR program carefully crafted to limit ratepayer risk as described below.

In its current application, PG&E requests authority "to establish an Economic Development Rate (EDR) that is specifically tailored to address varying economic conditions in the Company's service area". PG&E's current EDR, Schedule ED, is set to close to new customers at the end of 2012. PG&E states that it is submitting the current proposal as a replacement for Schedule ED, and that "PG&E's EDR proposal is designed to enhance California's competitiveness as a business location for companies to create or retain jobs for California residents."[14]

Specifically, in addition to retaining the "Standard" 5-year, 12% discount EDR option, PG&E proposes to create a new "Enhanced" EDR Option in counties where the annual unemployment rate for the previous calendar year was at least 125% of the state annual average. The Enhanced EDR Option will provide a 5-year, 35% reduction of an eligible customer's otherwise applicable tariff.[15] The Standard EDR Option, as well as the proposed Enhanced EDR Option, will continue to be available only to customers or

[14] PG&E, A.12-03-001, March 1, 2012, p.1-1.
[15] In both EDR options, the discounts would apply to the applicable tariff rate excluding taxes.

potential customers with credible out-of-state location options or who would otherwise cease operations.

As mentioned, the issue of adequate ratepayer safeguards is a key concern raised by PG&E's new EDR proposals, which would jettison many of the ratepayer safeguards built into the current EDR program. Chief among current safeguards is a floor price which consists of the sum of marginal costs and nonbypassable rate components. The floor price serves to ensure that nonbypassable rate components are not discounted and that the marginal costs of serving participating customers' demands are not shifted to other customers. PG&E now proposes to eliminate the floor prices, along with other safeguards such as third-party oversight of customer eligibility for EDR.

PG&E's rationale for eliminating the floor prices notes that the resulting "significantly smaller available discount made it difficult or impossible to offer a customer a sufficiently meaningful incentive to sway the location decision." DRA agrees that application of the current floor price did not enable PG&E to provide the full 12% discount otherwise allowed by the EDR program. However, DRA strongly disagrees with PG&E's proposed remedy, which is the complete elimination of a price floor for EDR contracts. DRA believes that a price floor is a necessary ratepayer safeguard, and discusses proposals for modifying the existing price floor to allow for meaningful discounts when warranted, while still protecting ratepayers from cost shifting.

Further supporting the need for a price floor, DRA notes that P.U. Code Section 740.4 (b), and (h), authorize rate recovery of EDR expenses "to the extent of ratepayer benefit". When a new customer moves into a utility service area, and begins to take service, the "marginal cost" is defined as the increase in the utility's overall cost of providing service resulting from the customer's demand. Therefore, "ratepayer benefit" is measured by the excess of the revenue provided by the customer above the marginal cost. This quantity is often termed "contribution to margin" or ("CTM"). Thus, a marginal cost-based floor price is needed to ensure a positive CTM, and thereby provide ratepayer benefit.

Lacking a price floor, PG&E's EDR proposals would result, in some instances, in a negative CTM over the proposed 5-year contract term.[16] DRA believes that such an outcome would violate the provisions of P.U. Code 740.4(b) and (h). While PG&E cites the benefits of job retention and job creation, these are not "ratepayer benefits" as that term is used in P.U. Code 740.4(b) and (h), and thus, cannot offset a negative CTM.

DRA also takes issue with PG&E's proposal to design its Enhanced EDR Option as a 35% discount in each year of the 5-year contract term. Not only would a 5-year 35% discount violate DRA's modified floor price proposal; it would also result in a nearly 50% rate increase if the customer returns to full tariff after the 5-year EDR contract term. To mitigate these effects, DRA proposes a declining discount for eligible customers in high-unemployment counties, beginning with a 35% discount in contract year 1 and declining to 30%, 20%, 15%, and 10% in contract years 2-5, respectively. DRA's proposal is roughly equivalent to a 22% discount over 5 years, and, in most instances, would be allowed by DRA's proposed modified floor prices.

In summary, DRA believes that a carefully crafted EDR program can be beneficial and is therefore prepared to support a modified version of PG&E's EDR proposals, with a declining Enhanced EDR discount, a modified floor price, and continued third-party oversight.

II. DISCUSSION

A. Benefits and Risks of EDR Discounts

As discussed above, the phrase "ratepayer benefit" in P.U. Code Section 740.4(h) has generally been taken to mean a positive CTM. Attracting a new customer or retaining a customer who would otherwise shut down would benefit existing ratepayers as long as the new or retained customer provides revenue that exceeds the utility's

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[16] PG&E's testimony asserts that, in all cases, the net present value of CTM would be positive in 10 years, under the assumption that the customer pays the full tariff rate after contract year 5. This is a rather strong assumption: there is nothing that would prevent a customer from leaving the State after 5 years, or seeking a second 5-year EDR contract; either action could result in a negative 10-year CTM if the initial 5-year CTM is negative.

marginal cost of service. PG&E's testimony describes other benefits, such as promoting economic growth, and retaining or expanding local employment opportunities. These are valid goals and potential benefits of EDR programs, but, in DRA's view, do not substitute for the statutory requirement of a positive CTM. The interpretation of Section 740.4(h) is further discussed in the "Key Policy Issues" section of this chapter.

Counterbalancing these benefits, there are two generic sources of ratepayer risk associated with EDR programs: (1) the cost of the discount itself, if the participating customer is, in fact, a "free-rider"; and (2) the possibility that the revenue from the customer might be insufficient to cover changes in the marginal cost over the contract term, causing the CTM to become negative.

A free-rider can be defined as an attraction or retention customer who accepts the EDR discount but who would have been attracted or retained without a discount. In such cases, the discount creates a revenue shortfall, requiring rates to nonparticipating ratepayers to be increased, with no offsetting benefit to those ratepayers not receiving a discount. While it is not possible to successfully screen out 100% of free-riders, the current EDR program has a number of safeguards restricting the eligibility for EDR discounts. These protections ideally prevent or discourage free-riders from obtaining EDR status. These safeguards, and PG&E's proposal to eliminate many of them, are discussed below. To the extent that free-riders sign up for EDR discounts, remaining ratepayers are at risk for the resulting utility shortfall.

The second source of ratepayer risk is the possibility of a negative CTM, resulting from either no floor price, or a weakened version of the current floor price. When customers fail to provide sufficient revenue to cover their marginal cost, remaining ratepayers could be at risk for making up the difference.

To summarize, the net ratepayer benefit of an EDR program is the aggregate CTM for non-free-riders, less the aggregate cost of the discount for free-riders. It bears repeating, that the keys to achieving positive net ratepayer benefits are:

(1) Imposing a price floor to ensure positive CTM; and

(2) Screening out free-riders.

B. THE CURRENT EDR PROGRAM

As discussed in PG&E's testimony[17], the Commission, in D.05-09-018, adopted a joint PG&E- SCE proposal for an EDR. To be eligible for the EDR, the customer must sign an affidavit attesting to the fact that "but for" this incentive rate, either on its own or in combination with a package of incentives made available to the customer from other sources, the customer would not have: (1) located operations or added load within the state of California; or (2) retained load within the state of California. Eligibility for EDR is determined jointly by PG&E and a State agency, the California Business Investment Services (CalBIS) in the Governor's Office of Business and Economic Development.

According to PG&E:

> "*Currently, Schedule ED requires that PG&E consult with CalBIS to determine qualified customers. CalBIS is the primary state clearinghouse for business attraction, expansion and retention projects. CalBIS reaches out to PG&E to help determine what assistance can be offered to companies which have indicated that energy availability and costs are a significant issue*."[18]

In Decision 05-09-018, the Commission also established a price floor below which any EDR customer's revenues could not fall. In D.07-09-016 and D.07-11-052, that floor price consisted of the sum of distribution marginal cost, generation marginal cost, transmission revenue, public purpose program charges, nuclear decommissioning charges, Department of Water Resources ("DWR") Bond charges and Competition Transition Charges.[19]

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[17] PG&E, A.12-03-001, March 1, 2012, p.1-2.
[18] PG&E, A.12-03-001, March 1, 2012, pp.2-2, 2-5.
[19] PG&E, A.12-03-001, March 1, 2012, p.1-2. Transmission charges, public purpose program charges, nuclear decommissioning charges, Department of Water Resources ("DWR") Bond charges, New System Generation Charges, Power Charge Indifference Adjustment ("PCIA") charges (when applicable) and

(continued on next page)

These features, which have persisted in the current EDR program, were intended to safeguard ratepayer benefits by limiting free-ridership and ensuring positive CTM. It is not possible to evaluate how well the affidavit process and eligibility screening have succeeded, since we cannot determine whether any given customer is or was a free-rider. Nonetheless, the Commission should continue to maintain or even strengthen reasonable safeguards against free-ridership.

The effects of the adopted price floor are easier to ascertain. Under the current additive price floor[20], a positive CTM is assured, even after nonbypassable charges ("NBCs") are fully paid and sequestered. As described in PG&E's testimony, the price floor is enforced annually, on an ex post as well as an ex ante basis.[21] Thus, the only source of ratepayer risk in the current EDR program is the cost of discounts given to free-riders. There is virtually no risk of a negative CTM since the discount given to participants is adjusted during the 5-year contract life to eliminate any negative CTM.

While the current EDR program can be characterized as "low risk" for ratepayers, as PG&E points out, the benefits of the current EDR program have been limited.

According to PG&E:

> *"The average first-year incentive for contracts executed with a floor price including both NBCs and 2007 marginal costs, was only 7.3 percent.*

(continued from previous page)
Competition Transition Charges are all either nondiscountable or nonbypassable (or both). For simplicity, these rate components will be identified as nonbypassable charges ("NBCs") for the purpose of this testimony.

[20] The term "additive" price floor refers to the addition of marginal costs and nonbypassable costs to determine the floor price in the current EDR program. In Chapter 2, Transmission and DWR Bond charges are described as both marginal costs and NBCs. However, they are counted only once in determining the current additive price floor. The same is true for the modified additive price floor proposed by DRA in Chapter 2.

[21] As described by PG&E, existing Schedule ED customers with contracts based on the 2007 marginal costs have seen their discounts reduced during the required annual contract reviews, as a result of declining generation rates and increased generation marginal costs. PG&E, A.12-03-001, March 1, 2012, p.2-4.

Further, "the headroom supporting even these modest incentives has been further eroded by declining generation rates. All but one of the post-2007 contracts were initially evaluated using rates in effect during 2009. From March 2009 to March 2011, the average generation component of electric rates for large light and power customers declined from an average of $0.082 to $0.065 per kilowatt-hour, about 20 percent, while overall average rates increased by about 2 percent. The significant reduction in the generation component of the rate has been largely offset by increases in the transmission and NBC components of the rate. These same components flow directly through to the floor price, but have not been offset by parallel reductions in the marginal generation component of the floor price, which remained frozen at the artificially high 2007 levels.

The combination of the decline in generation revenue and elevated generation marginal costs in the floor price squeezed what little headroom there was, causing a reduction [below the authorized 12% discount], or even elimination, of the Schedule ED rate incentive."[22]

As a result [of the application of the current floor price], PG&E states that it has been "challenged in offering a convincing rate incentive to new customers".[23]

C. PG&E'S PROPOSED CHANGES TO THE EXISTING EDR PROGRAM

PG&E proposes changes to the applicant screening and eligibility requirements of the current EDR, and to eliminate the price floor provisions in the current EDR. These are further described below.

1. Proposed EDR Program Eligibility Changes

With respect to customer eligibility, PG&E states that its proposed standards for the new EDR program are similar to those in the current Schedule ED:

- Businesses must have at least 200 kW of load and must be taking service on PG&E's commercial and industrial rate schedules

[22] PG&E, A.12-03-001, March 1, 2012, p.2-3.
[23] *Ibid.* p.2-4. Presumably PG&E was also "challenged" in regard to offering EDR to existing customers, as well.

- Businesses must be in the process of locating, retaining or expanding major business facilities and also must be actively pursuing out-of-state location options for that load or otherwise would cease operations.
- Applicants must sign an affidavit, under penalty of perjury, that "but for" the EDR incentive, either on its own or in combination with a package of other economic development incentives, the customer would not have located or retained the load in the state of California.

However, unlike the current Schedule ED, PG&E proposes to merely "inform CalBIS of each EDR offer to ensure that any package of incentives for a particular customer will be coordinated with the EDR incentive."[24] In other words, PG&E seeks sole authority to determine EDR eligibility without prior approval by CalBIS or another third party.

In addition, PG&E proposes that customers can qualify for Enhanced EDR who meet the above EDR eligibility requirements and are locating in a county experiencing an unemployment rate equal to 125% or more of the state's average annual unemployment rate[25].

2. Changes to the Customer Affidavit and Contract

PG&E proposes significant changes to the current customer affidavit, among them, deletion of the current provision requiring that energy costs be at least 5% of customer's operating expenses.[26] It is necessary to retain this clause in the affidavit in order to guard against free-riders.

PG&E also proposes to alter the Liquidated Damages clause in the Contract which has been included in the past EDR program contacts.[27] PG&E proposed to not include the provision that holds applicants responsible for repaying the discount if they terminate

[24] PG&E, A.12-03-001, Prepared Testimony, March 1, 2012, p.2-5.

[25] *Ibid.* California unemployment rates are reported in "Report 400 C, Monthly Labor Force Data for Counties, Annual Average 2010 – Revised," by the State of California Employment Development Department ("EDD").

[26] *Ibid.*, Chapter 3, Attachment A, p.5.

[27] *Ibid*,. Chapter 3, Attachment A, p.3.

their EDR contract early. This clause should be retained to limit the risk to ratepayers and protect against free-riders.

3. Proposed Elimination of EDR Floor Price

PG&E proposes to eliminate the current EDR price floor. According to PG&E: "PG&E's proposed EDR contains no price floor."[28] PG&E states that the current after-the-fact annual review of the customer's revenues against the Schedule ED price floor for each contract "proved unworkable for its customers, and diminished the effectiveness of the rate."[29]

4. Effect of PG&E's Proposed EDR Changes

PG&E's proposed changes would give PG&E sole discretion over EDR eligibility, and make it easier for customers to qualify. DRA believes that these changes would increase the risk of loss to ratepayers due to free-riders, and therefore opposes the proposed changes to the eligibility requirements.

DRA accepts that some changes to the current floor price may be warranted, and sets forth a modified floor price proposal below. There is no evidence that PG&E considered proposing changes to the floor price calculation that would improve customer acceptance and still provide ratepayer protections. As discussed above, retention of a floor price is essential to meeting the statutory test of "ratepayer benefit" for an EDR program. The Commission must not approve PG&E's ill-considered proposal to eliminate the floor price for EDR contracts.

D. Need To Maintain A Balance Between Ratepayer Risks & Economic Development Rewards

As discussed above, EDR contracts involve both potential benefits and potential risks to ratepayers.   Ratepayers stand to benefit from EDR contracts to the extent that customers provide positive CTM that would not have materialized "but for" the EDR discount.   Ratepayers stand to lose to the extent that EDR contracts are awarded to free-

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[28] PG&E, A.12-03-001, March 1, 2012, p.2-7.
[29] *Ibid.*

riders or to the extent that CTM is negative. In both of the latter outcomes, costs could be shifted to nonparticipating ratepayers.

In deciding whether an EDR program meets the statutory "ratepayer benefit" test, the Commission must take into account the ratepayer risks as well as the benefits claimed by the utility, and must strive to ensure that the benefits outweigh the risks. Because the current EDR program enforces a "tight" price floor and reasonable eligibility safeguards against free-riders, it can be considered, relatively speaking, a "low-risk" to ratepayers. However, PG&E states that the benefits of the current EDR program are limited and uncertain, and implies that the current EDR program may not be sufficient "to meet the objective of increasing California's competitiveness."[30]

DRA accepts the desirability of improving the effectiveness and attractiveness of the current EDR program, but believes that changes to the current program must ensure that risks and benefits remain in reasonable balance, with a high likelihood that benefits will outweigh the risks. DRA believes that the current EDR program can be modified to make it more effective and attractive, albeit with a concomitant increase in ratepayer risk.[31] Accordingly, DRA proposes a modified version of PG&E's EDR proposal, with a modified pricing floor to guard against negative CTM, and strengthened eligibility requirements, to guard against free-riders. DRA's EDR proposals are described in detail in Chapters 2 and 3 of this testimony.

E. IDENTIFICATION OF THE KEY POLICY ISSUES

PG&E's proposal is very complex and multi-faceted. In raises a number of policy issues which will be discussed below.

[30] *Ibid.*
[31] DRA proposes that PG&E's shareholders bear a portion of the increased risk.

1. The definition of ratepayer benefit in Public Utilities Code §740.4(h) requires a positive contribution to margin over the contract term

The Commission has the authority to encourage economic development under PU Code § 740.4.[32] The Commission can authorize a variety of economic development activities[33] and is empowered to approve and regulate PG&E's proposed EDR program. The Commission's authority to authorize economic development activities is constrained by PU Code § 740.4(h), which requires all economic development activities approved by the Commission to result in a benefit to ratepayers. PU Code § 740.4(h) states:

> *"It is the intent of the Legislature that the Public Utilities Commission, in implementing this chapter, shall allow rate recovery of expenses and rate discounts supporting economic development programs within the geographic area served by any public utility to the extent the utility incurring or proposing to incur those expenses and rate discounts demonstrates that the ratepayers of the public utility will derive a benefit from those programs."*

A major issue in interpreting this statute is whether the ratepayers, which "will derive a benefit from these programs," are limited to the EDR program non-participants, or whether the term is expansive enough to also include the participating ratepayers. It cannot include both since the aggregate ratepayer benefit would be zero if the program is set up so that non-participants fund the EDR discounts, as is normally done. Thus it makes sense that the demonstration of benefits called for by statute must be explicitly be performed from the point of view of the EDR program non-participants.

CTM explicitly measures the impact on non-participants who do not realize any other rate benefits other than that associated with the CTM. Thus, DRA believes that in order to satisfy the ratepayer benefit requirement of PU Code § 740.4(h), a positive CTM is required over the term of the EDR contract.[34] DRA's interpretation of PU Code §

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[32] This section addresses Scoping Memo Issue #8.
[33] PU Code § 740.4(c).
[34] The following section addresses Scoping Memo Issue #9.

740.4(h) is supported by the Commission's understanding of "ratepayer benefit" discussed in the following Finding of Fact in Decision 05-09-018:

> *"The implementation of successful economic development projects would* ***benefit ratepayers*** *directly by increasing the revenues available to contribute to the utilities' fixed costs of doing business, thus lowering rates to other customers*."[35]

The benefit to ratepayers described above is embodied in the CTM. The Commission defined CTM in Decision 96-08-025 as "the difference between the average rate paid by a customer and the marginal cost of serving that customer."[36] This definition of CTM is equivalent to the ratepayer benefit described above in Decision 05-09-018. Indeed, the Decision describes ratepayer benefit as "increased revenues that contribute to the utilities fixed cost of doing business,"[37] which is the same as the definition of CTM in Decision 96-08-025, which is "revenues in excess of the marginal cost of serving that customer."[38] Moreover, the "fixed costs of doing business" are the margin to which new revenues are contributing. Given the equivalence of "ratepayer benefit" and a positive CTM, PU Code § 740.4 is best interpreted to require a positive CTM.

It should be noted that the definition of CTM in Decision 96-08-025 is broader than the definition of ratepayer benefits in Decision 05-09-018 given that the latter only discusses increasing sales. But a similar benefit results, from retaining a customer that would depart "but for" the EDR discount, given that the discount will ensure that existing revenues will continue to be available to contribute to the utilities' fixed costs of doing business. This is important because most EDR contracts, 10 of the past 14, have been for customer retention, and this trend may be likely to continue.[39]

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[35] D. 05-09-018, p.26, FOF #2 (emphasis added).
[36] D. 96-08-025, p.5.
[37] D. 05-09-018, p.26.
[38] D. 96-08-025, p.5.
[39] 2010 & 2011 PG&E Reports on Economic Development Applications, See, Appendix D.

According to PG&E, its proposed EDR program would result in benefits to ratepayers because the program will yield a positive CTM over 10 years.[40] In its Testimony, PG&E presents CTM based on a net present value over a 10-year period, which assumes that EDR customers will serve a full 5-year term under the EDR program and then return to the normal rate schedule for an additional 5 years. This analysis of CTM is a major departure from the current EDR program which includes a floor price that guarantees that EDR contracts will yield a non-negative CTM every year.[41] DRA does not agree that the Commission should rely only on a 10-year CTM analysis to determine ratepayer benefits. PG&E's analysis shows a negative 5-year CTM present value for its proposed Enhanced EDR discount for some rate schedules.[42] This is a major flaw in PG&E's proposal and cannot be solved by simply assuming a 10-year time frame for the CTM analysis.

By presenting only a 10-year CTM analysis based on an assumption that the customer will remain in business and pay the full tariff rate in years 6 -10, PG&E's approach is, to some extent, speculative. PG&E does not account for the fact that EDR customers could leave the state after 5 years or go bankrupt. Under these circumstances, any negative CTM incurred to serve EDR customers during the contract term would be shifted to non-participating ratepayers and would not be compensated for by positive CTM accrued in years 6 -10. This would violate longstanding Commission policies prohibiting cost shifting, as well as subject ratepayers to undue and unacceptable risk. To guard against this risk, CTM should be analyzed over the proposed 5-year EDR contract term and under PU Code § 740.4, the CTM must be positive at the end of the 5-year term. This is further discussed in Chapter 2.

DRA acknowledges that the EDR program could result in other benefits for ratepayers and the State of California in general. These additional benefits include

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[40] See, PG&E, A.12-03-001, March 1, 2012, Table 3-1, p.3-3.
[41] D 10-06-015, p.7.
[42] PG&E's testimony does not include a 5-year CTM analysis, but 5-year CTM results from PG&E's
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increased employment opportunities and improved overall local and economic vitality.[43] The Commission has acknowledged these indirect benefits in prior EDR decisions[44] but has established that these indirect benefits alone are insufficient to satisfy the ratepayer benefit requirement of PU Code § 740.4(h) and cannot substitute for the need for EDR contracts to provide a positive CTM over the contract term. In fact, Decision 10-06-015 seems to distinguish job creation and ratepayer benefits by calling the latter "another benefit" in the following citation:

> *"The goal of the EDR program is to attract and retain those businesses in California that would otherwise go out of business or leave the state, reducing the number of jobs available to Californians. Another benefit of the program was to reduce the amount of fixed costs that would otherwise have been borne by remaining ratepayers if these businesses had gone out of business or left the state."*[45]

Clearly, the EDR program must generate a positive CTM over the 5-year term of the EDR contract in order to satisfy the ratepayer benefit requirement enumerated in PU Code § 740.4(h).

2. The discounting of nonbypassable charges is prohibited by Decision 07-09-016

Nonbypassable charges ("NBCs") are rate components collected to fund public purpose programs and other fixed charges the utility must recover through rates. In Decision 06-05-042, the Commission enumerated a list of NBCs: "transmission charges; pubic purpose program charges; nuclear decommissioning charges; DWR ("Department of Water Resources") Bond Charges; Competition Transition Charge." In Decision 07-09-016, the Commission considered the question of whether NBCs could be discounted in order to allow direct access customers to receive an equivalent EDR discount as

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EDR proposals can be gleaned from PG&E's workpapers. These results are shown in Appendix C.
[43] D. 05-09-018, p. 12.
[44] *Ibid.*
[45] D. 10-05-016, p.2

bundled customers. The Commission reached the following Conclusions of Law regarding the discounting of NBCs:

> *"1. All nonbypassable charges are nondiscountable…" and*
> *"3. No exemptions or exceptions for EDR customers are permissible under applicable statutes."*

Decision 07-09-016 clearly establishes that NBCs cannot be discounted and must be collected from all customers. Therefore, PG&E must collect NBCs from all of its customers, including those participating in the EDR program. As discussed in Chapter 2, the need to fully collect NBC's precludes PG&E's proposal to allow negative distribution rates.[46]

3. DRA's EDR program proposal appropriately results in a smaller discount for DA/CCA customers

DRA's proposed price floor for the EDR program could result in the availability of a smaller percentage discount to some direct access ("DA") and community choice aggregation ("CCA") customers than the discount proposed for bundled service customers.[47] Due to the Commission's ruling in Decision 07-09-016, that NBCs cannot be discounted, DA/CCA customers can only receive a discount on their distribution rates. DRA proposes that distribution rates for both bundled and DA/CCA customers should not be discounted below marginal cost. Thus DA/CCA customers are eligible to receive a limited discount under the EDR program that is similar to the ***distribution*** rate discount that bundled customers would receive. Potential EDR bundled customers are eligible to receive a larger discount because their generation rate also can be discounted. PG&E can only discount the services it provides to a customer. The Commission affirmed this principle in the most recent EDR decision, "the EDR discount will be calculated based on

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[46] This is true, at a minimum, for DA and CCA customers, for whom all rate components, with the single exception of Distribution, are nondiscountable. DRA further recommends that negative distribution rates not be allowed for *any* EDR customer, for reasons discussed in Chapter 2.
[47] This section addresses Scoping Memo Issue #5. As explained in Chapter 2, DA and CCA customers located in constrained distribution areas must be offered smaller discounts, to avoid violating the modified additive price floor.

those rate components of the EDR customer's bill that correlate to services the Utilities provide to the EDR customer."[48]

Providing a smaller EDR discount to DA/CCA than to bundled customers is permissible according to Commission decisions approving past EDR programs.[49] In Decision 05-09-018, the Commission ruled to exclude NBCs from the floor price in order to rectify the fact that DA/CCA customers participating in the EDR program were receiving a smaller discount than bundled customers. Decision 07-09-016, re-explored this issue and determined that, despite the unequal impact on DA/CCA customers, NBCs could not be discounted.[50] The most recent Commission decision regarding the EDR program, Decision 10-06-015 did not modify the floor price calculation method established in Decision 07-09-016.

III. NEED FOR THE EDR PROGRAM

A. ECONOMIC CONDITIONS AND UNEMPLOYMENT STATISTICS SUGGEST A NEED FOR THE ECONOMIC DEVELOPMENT RATE

As PG&E's testimony points out, California's economy has struggled since the recession started in December 2007. Unemployment levels in the state have reached historically high levels in recent years, though there are modest signs of improvement. In 2010, California's average annual unemployment rate was 12.4%,[51] and it dropped to 11.7% in 2011.[52] Nevertheless, California's economy continues to struggle.

PG&E proposes to offer the enhanced EDR program in counties that have an unemployment rate of 125% of the state's average annual unemployment rate. PG&E relies on 2010 data in its application. According to the 2011 annual unemployment data, 125% of the state annual average unemployment rate would be 14.6%. Data on the

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[48] D 10-06-015, p.7-8.
[49] D 06-05-04;, D 07-09-016; D 10-06-015.
[50] D 07-09-016, p.31.
[51] State of California Employment Development Department, "Report 400 C, Monthly Labor Force Data for Counties, Annual Average 2010-Revised."
[52] State of California Employment Development Department, "Report 400 C, Monthly Labor Force Data for Counties, Annual Average 2011-Revised."

county monthly labor force indicates that 21 counties would be eligible for the enhanced EDR program because their unemployment rate exceeds 14.6%.[53]

These 21 counties have unemployment rates ranging from 14.6% to 20.4% and are mostly located north of the Bay Area and in the Central Valley. Fresno is the largest city in the 21 counties, and has the highest concentration of poverty of any large city in the United States.[54] Another large city in the high unemployment counties is Stockton, which has the worst jobless rate nationwide.[55] The high unemployment counties have been hit hard by the recession and additional economic development measures are necessary to help stimulate these economies.

According to PG&E, the EDR program has proven to be a successful jobs creator in the past. As PG&E states, "a total of approximately 5,055 jobs have been created and retained by the 15 customers with Schedule ED contracts since its inception in 2005."[56] Also, recent studies indicate that the EDR program will serve as a major incentive for businesses location decisions. According to professional site location consultants, "energy availability and costs" is the fifth most important site selection factor of mid- to large-scale manufacturing operations.[57]

California is in need of economic development measures that make it more attractive for large manufacturing industries.[58] The EDR program could offer the necessary benefits to elicit growth in the state's economy, and to create and retain employment opportunities. DRA is supportive of a modified version of the EDR program for these reasons, assuming the additional ratepayer safeguards recommended herein are incorporated into the program.

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[53] *Ibid.*
[54] Annie E. Casey Foundation/Brookings Institution report, "Katrina's Window: Confronting Concentrated Poverty Across America." http://www.aecf.org/upload/publicationfiles/katrina%201.pdf. See, Appendix F.
[55] MarketWatch, December 13, 2011, http://www.marketwatch.com/story/california-florida-ohio-cities-in-bottom-10-2011-12-13. See, Appendix F.
[56] Merced Irrigation District & Modesto Irrigation District Data Request Response 1, question 04c. See Appendix E.
[57] 7th Annual Consultants Survey, Area Development Magazine, Winter 2011. See, Appendix F.
[58] This paragraph addresses Scoping Memo Issue #1.

IV. NEED FOR RATEPAYER SAFEGUARDS

DRA supports an EDR program as a limited term solution to California's current economic climate. A considerable amount of ratepayer risk would be created by the substantial discount offered under PG&E's proposed EDR programs. For this reason, the EDR programs need to be modified, carefully crafted, and appropriately applied to obtain the desired benefits without undue risk to ratepayers.

A. SCREENING OUT FREE-RIDERS

PG&E proposes to offer the largest EDR discount ever in the history of the program. PG&E simultaneously proposes to strip a majority of the ratepayer safeguards from the EDR program. These two factors create a potentially dangerous situation for ratepayers because this EDR program is likely to attract the most participants ever and PG&E's proposal does little to guarantee that the participants' discounted rates will cover their cost of providing service to them. A relatively small number of free-riders receiving a 35% discount could cause the entire EDR program to result in increased costs which nonparticipating ratepayers would have to absorb under PG&E's proposal. This highlights the importance of proper screening for free-riders in the application process.

B. LIMITING RATEPAYER EXPOSURE

The economic data discussed earlier in this chapter establishes that California's economy is weak and unemployment is a huge problem throughout much of the State. Now, more than ever, Californians are struggling to make ends meet, especially the unemployed. Under PG&E's proposal, if the EDR program results in a negative CTM, all non-participating ratepayers will be forced to cover the difference, including residential and small business ratepayers. Any increase in energy rates could impact residential ratepayers who are unemployed and small businesses that are struggling to survive. In order to protect these ratepayers, it is absolutely necessary that any EDR program limit unwarranted ratepayer exposure to risk.

As discussed in Chapter 3, PG&E's shareholders, as well as its ratepayers, stand to benefit from a successful EDR program. While DRA's EDR proposals would mitigate much of the substantial ratepayer risk embodied in PG&E's EDR proposals, even DRA's somewhat scaled-back EDR proposals present significantly more risk to ratepayers than the current EDR. In light of the potential shareholder benefits, DRA proposes that PG&E shareholders be required to bear some of the risks of an expanded EDR program.[59]

C. NEED FOR PROGRAM CAP

The EDR program should be limited by a strict participation cap. PG&E's existing schedule ED program has a program cap of 200 MW.[60] This cap is necessary to limit the exposure to risk for non-participating ratepayers. A cap on the EDR program could also limit the number of free-riders. A program cap is necessary especially because of the unprecedented magnitude of the enhanced EDR discounts and the associated risk posed to non-participating ratepayers.

V. CONCLUSION

The EDR program has the potential to be a useful economic development tool if administered correctly. PG&E's proposed EDR program subjects nonparticipating ratepayers to an unnecessarily large amount of risk. In the following two chapters, DRA proposes many changes to the EDR program that will protect ratepayers and ensure the effective and efficient administration of the EDR program.

[59] The Commission has acknowledged the propriety for shareholder participation in rate discounts in past Commission precedents. Resolution E-3654, D 07-09-016. Also, since any decision by PG&E to offer EDR contracts would be voluntary, such a shareholder contribution cannot be construed as a "taking" under the law.
[60] D 10-06-015 at p.10.

CHAPTER 2. EDR DISCOUNTS AND FLOOR PRICES

(Witness - Robert Levin)

I. INTRODUCTION AND SUMMARY

PG&E proposes to continue the Standard EDR option of a 12% discount over a 5-year contract term, and to offer an Enhanced EDR option of a 35% discount in counties in which unemployment is 125% of the State average. In conjunction with these proposals, PG&E proposes to eliminate the current EDR price floor. According to PG&E, EDR contracts have been subject to price floors since at least D.05-09-018.

DRA believes that a floor price is a necessary component of an EDR program, and is needed to ensure that ratepayers will benefit through a positive CTM. DRA also believes that CTM is the best measure of ratepayer benefits for an EDR contract, and PG&E appears to concur that CTM is an appropriate measure of ratepayer benefits:

> *To the extent that utilities can retain or attract sales at a rate that is lower than the tariffed rate, but higher than the marginal cost, helps to maintain or add to Contribution to Margin (CTM). This CTM can then be used to keep rates to customers lower than they would otherwise be. .... A program benefits ratepayers if the CTM is greater than zero.*[61]

However, PG&E's testimony further states:

> *PG&E's presentation of CTM is based on a Net Present Value (NPV) over a 10-year period (i.e., calculating the NPV of the 10-year stream of annual CTM amounts, 5 years under EDR, and an additional 5 years under full tariff rates). ....The 10-year NPV of CTM in each situation is positive, and therefore supports approval of PG&E's proposed EDR.*

DRA does not agree that a positive 10-year CTM projection is sufficient to establish the ratepayer benefits necessary to Commission approval of EDR. As shown in

[61] PG&E, A.12-03-001, March 1, 2012, p.3-2.

Table 2-1, PG&E's analysis shows a negative 5-year CTM present value for its proposed 35% Enhanced EDR discount for some rate schedules.

Table 2-1: Five-year CTMs for Bundled Service Customers[62]

PG&E 5-Year NPV of Participant CTM ($1,000)

	E-20T	E-20P	E-20S	E-19P	E-19S	A-10S
12% Discount, Unconstrained	498	1141	1338	314	356	190
12% Discount, Constrained	498	620	808	177	211	116
35% Discount, Unconstrained	-233	221	329	77	99	61
35% Discount, Constrained	-233	-299	-201	-60	-47	-13

The expectation of a negative 5-year CTM should raise a red flag for the Commission for two reasons. First, there is no guarantee that the customer will continue to take service from PG&E during the entire 10-year analysis period. If the customer leaves the State or goes bankrupt soon after the EDR contract expires, there may not be enough positive CTM to outweigh a 5-year negative CTM present value over the contract term. Worse, the customer could leave before the termination of the contract, thus leaving ratepayers with a negative CTM with no offsetting positive CTM. While some money might be recovered for ratepayers through the liquidated damages provisions of the EDR contract, such recovery is, at best, uncertain.

The second reason for caution is the fact that the marginal cost can change during the 5-year contract term. Currently, EDR discounts are "trued-up" annually, after the fact, for changes to the marginal cost used in computing the floor price.[63] This ensures against a negative CTM. DRA proposes that EDR contracts be required to have a positive 5-year ex ante (i.e., forecasted) CTM. This will at least reduce the likelihood that the ex post CTM will turn negative due to unforeseen increases in the marginal cost. If the ex-post 5-year CTM does turn negative, and does not turn positive after 10 years,

[62] Table 2-1 is based on the marginal costs presented in PG&E's "Workpapers Supporting Chapter 3", dated March 1, 2012, and including generation and distribution marginal costs, the full transmission rate, and the DWR bond charge. The marginal cost and rate assumptions for Table 2-1 are identical to the assumptions underlying Table 3-1 on p.3-3 of PG&E's March 1, 2012 testimony; the only difference being the calculation of a 5-year NPV vs. a 10-year NPV.

DRA proposes that shareholders absorb the cumulative negative CTM. This proposal is discussed in Chapter 3 of DRA's testimony.

In summary, EDR contracts should be required to achieve a positive CTM on an ex ante basis over the proposed 5-year contract term. To accomplish this, EDR contracts must be subject to a floor price.

II. FLOOR PRICES FOR EDR CONTRACTS

A. THE CURRENT EDR PRICE FLOOR

As adopted by D.07-09-016 and D.07-11-052, the current EDR price floor is the sum of the marginal cost of service and the nonbypassable costs. The marginal cost of service includes the marginal costs of generation and distribution, together with the full retail transmission revenue[64] and the DWR bond charge[65].

Table 2-2 lists PG&E's rate components, and describes which are nonbypassable. For example, for Public Purpose Programs ("PPP"), the pertinent statutes, case law, and final Commission decisions uniformly hold that PPP surcharges are nonbypassable and cannot be discounted. This is further discussed in Chapter 3. Other nonbypassable costs include Nuclear Decommissioning, the Competition Transition Charge ("CTC"), the Department of Water Resources ("DWR") bond charge, and the New System Generation Charge ("NSGC"). Since transmission, like nonbypassable charges, cannot be discounted by the CPUC, it can be regarded as both a nonbypassable cost and a marginal cost. The same is true of the DWR bond charge.

(continued from previous page)
[63] PG&E, A.12-03-001, March 1, 2012, p.2-7.
[64] The full retail transmission revenue is considered a marginal cost because transmission is FERC regulated and each unit of demand must pay the fixed per kWh transmission charge set by FERC.
[65] California Department of Water Resources bond charge. By law, each unit of demand must pay a fixed per kWh charge, until the DRW bonds are paid off. Thus, in the short-run, at least, DRW bond charges are marginal costs.

Table 2-2 PG&E's Rate Components and Current EDR Price Floors

Rate	Nonbypassable and/or Nondiscountable	Marginal[66]	Component Price Floor
Transmission	X	X	Full Rate
Distribution		X	Marginal distribution cost
Public Purpose Programs	X		Full Rate
Nuc. Decom.	X		Full Rate
Generation		X	Marginal generation cost
CTC	X		Full Rate
NSGC	X		Full Rate
DWR Bond	X	X	Full Rate

The current price floor allows discounts only to the generation and distribution rate components, subject to a marginal cost floor which is enforced annually on both ex ante and ex post bases. In this manner, the current price floor effectively prevents the occurrence of a negative CTM.

As PG&E has noted, the application of the current price floor has restricted PG&E's ability to offer the standard 12% EDR discount[67]. DRA estimates that the current floor price methodology, if retained, would allow discounts to bundled service customers ranging from 8% to 17% depending on the rate schedule. Thus, in some cases, the full 12% Standard EDR Option discount could not be granted, let alone the proposed Enhanced EDR discount. Further, as PG&E notes, the current practice of after-the-fact "true-ups" of the customers' bills to reflect changes in marginal cost introduces an undesirable level of uncertainty for EDR customers[68].

[66] Costs which change with demand or energy usage
[67] PG&E, A.12-03-001, March 1, 2012, p.2-3.
[68] *Ibid.*, p.2-7

In response to need, DRA proposes to modify the current EDR price floor to allow meaningful EDR discounts while complying with legal requirements and preserving ratepayer safeguards.

B. DRA's EDR Price Floor Proposal

To address the current economic recession, DRA proposes, as a temporary measure, to replace the current additive price floor with a combination of three less stringent price floors, all of which must be met over appropriate time intervals (1 year or 5 years). DRA's floor price proposal will ensure: (1) that NBCs are not discounted; and (2) that the 5-year net present value of the CTM is not negative, on an ex ante basis. Table 2-3 summarizes DRA's 3-fold floor price proposal.

Table 2-3: DRA's 3-fold floor price proposal.

	Floor price calculation	Enforcement	Purpose
NBCs	Sum of all rate components except Generation and Distribution[69]	Annual	Prevent discounting of NBCs
Marginal cost	Sum of Generation & Distribution MC + Transmission and DWR bond charges	Revenue must exceed MC on a 5-year NPV basis	Prevent negative CTM over contract life
Modified additive price floor	Sum of NBCs and MC, Excluding Marginal Generation Capacity Cost	Revenue must exceed Modified additive price floor on a 5-year NPV basis	Provide additional ratepayer protection

DRA believes that the separate application of the NBC price floor and the MC price floor would satisfy the legal requirements of an EDR: that NBCs not be discounted and that ratepayers benefit (via a positive CTM over the 5-year contract term). Implicit in this framework is the assumption that NBC revenues, other than Transmission and DWR bond charges, count towards CTM. For attraction customers, the costs associated with the NBCs can be viewed as part of the margin, and any amount of new revenues brought

[69] For DA and CCA customers, NBCs include PCIA charges, in addition to all other NBCs paid by bundled service customers.

in will contribute to paying for the NBCs, many of which are fixed costs[70]. However, since a large percentage of the EDR participants are expected to be retention customers, a third test also is provided to assure that both the NBCs and marginal costs are collected. However, as described below, the proposed modified additive floor price incorporates a lower marginal cost than the marginal cost in the current price floor.

Under the current additive price floor, NBC revenues are effectively "sequestered" and do not count toward CTM. While the current EDR floor price confers a high level of ratepayer protection, DRA is willing to temporarily accept a less stringent ratepayer safeguard in order to allow meaningful discounts in the current economic emergency. Accordingly, DRA proposes that the NBC and MC price floors be applied separately, with the modified additive price floor as a further ratepayer safeguard.

DRA's proposed modified additive price floor differs from the current fully additive price floor by the exclusion of the Marginal Generation Capacity Cost ("MGCC"). DRA notes that EDR contracts are proposed to be in effect for 5 years; initial contracts signed in 2013 will expire in 2018. Though there currently is considerable uncertainty about whether PG&E will need new generation capacity before 2018, recent indications suggest that PG&E will not need new generation capacity before 2020.[71] Thus, there may be relatively little ratepayer risk caused by excluding the MGCC from the additive price floor. DRA, however, does include the MGCC in its separate marginal cost floor.

The other major difference between the current EDR price floor and DRA's proposed price floor is that DRA would allow a negative CTM in the initial contract years, as long as the 5-year present value of CTM is non-negative. While this feature does increase ratepayer risk, DRA believes that increased risk is manageable provided

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[70] This applies only to NBCs other than Transmission and DWR Bond charges, which are treated as both marginal costs and NBCs.

[71] See, e.g., North American Electric Reliability Corporation ("NERC") 2011 Long-Term Reliability Assessment, November 2011, p.463, Fig. 129. A similar conclusion was reached in the 2010 Long-Term Procurement Planning ("LTPP") proceeding (R.10-05-006).

EDR contracts continue to include adequate liquidated damages provisions as discussed in Chapter 3.

1. DRA's Proposed Changes to PG&E's Marginal Costs

Although PG&E proposes to discontinue the Commission's current practice of requiring a floor price for EDR discounts, it provided marginal costs for the purpose of estimating 10-year CTMs for EDR customers. As shown in Table 2-4, PG&E's marginal costs decline sharply after year 1, then remain constant between years 2 to 10. PG&E states that its year 1 value is based on the Settlement that was adopted in A.10-03-014, and that its year 2-10 values are based on indexing the price of natural gas and reflects recent commodity price decreases.

DRA proposes two adjustments to PG&E's marginal generation costs. First, DRA recommends a blended approach which averages the year 1 and year 2-5 values over the 5-year contract term, using a weighted average which assigns a weight of 20% to the Settlement value and 80% to the indexed value. This blended MC estimate is carried forward to years 6 through 10. Second, PG&E's MGCC used in its CTM calculations exclude the 15% Resource Adequacy ("RA") adder that is included in the MGCC used for rate setting. DRA's proposed marginal costs include the 15% RA adder in the MGCC. DRA's blended marginal energy costs are used in both DRA's proposed marginal cost floor price and DRA's proposed modified additive floor price. The former also includes the MGCC with the 15% RA adder; the latter does not.[72]

The results of DRA's adjustments are also shown in Table 2-4. The second to last column represents includes generation capacity costs. Thus it shows the values that

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[72] Neither PG&E's nor DRA's marginal generation costs include a component to account for the marginal cost associated with renewables. A change in energy consumption can affect the costs of compliance with California's Renewable Portfolio Standard ("RPS"). Conceptually, this should affect the marginal energy cost. Energy And Environmental Economics (E3) has acknowledged this effect and has included an RPS component in its avoided cost analyses and calculators. TURN proposed an RPS adder in recent California IOU GRC Phase 2 proceedings. While DRA has not included an RPS adder in its proposed marginal costs, DRA may support such an adder if proposed by another party. Whether or not an explicit RPS adder is included in marginal cost floor prices, DRA believes that the cost of RPS compliance varies with energy use, and thus, RPS costs are conceptually a legitimate part of the marginal energy cost.

would be would be used in the marginal cost floor. The last column is the value used in the "modified additive floor price."

Table 2-4: PG&E and DRA Proposed Marginal Generation Costs

Proposed Generation MCs					
	PG&E Year 1	PG&E Year 2-10	DRA Year 1-10	DRA Year 1-10 w/ RA adder	DRA Year 1-10 (Energy Only)
E-20T	0.06742	0.04557	0.04994	0.05189	0.03695
E-20P	0.07085	0.04832	0.05283	0.05504	0.03810
E-20S	0.07460	0.05113	0.05582	0.05824	0.03969
E-19P	0.07206	0.04941	0.05394	0.05629	0.03831
E-19S	0.07684	0.05326	0.05798	0.06069	0.03986
A-10S	0.07993	0.05607	0.06084	0.06391	0.04035

2. Effects of DRA's Proposed Changes to PG&E's Marginal Costs

Except for year 1, DRA's proposed marginal costs are higher than PG&E's. This produces a slight reduction in the CTMs as computed by PG&E[73]. However, the 10-year CTMs remain positive. DRA's CTM calculations are compared with PG&E's CTM calculations in Appendix G[74]. Because DRA's marginal cost adjustments are relatively small, they are not likely to have a major impact on the ability of customers to qualify for EDR. But DRA's adjustments will help to mitigate the ratepayer risks resulting from alterations to the current strict additive EDR price floor.

3. DRA's Proposed EDR Price Floors for Bundled Service Customers

The numeric values ($/kWh) of DRA's proposed price floors for bundled service customers are shown in Table 2-5. These price floors include DRA's proposed marginal

[73] See PG&E, A.12-03-001, March 1, 2012. e.g., Table 3-1 on p.3-3.

[74] In Appendix G, Tables G-1 through G-3 present CTMs for bundled service customers, for PG&E's and DRA's discounted rate proposals. Tables G-4 and G-5 present CTMs for DA and CCA customers. While the CTMs in Tables G-4 and G-5 are positive in all cases, in some DA and CCA cases PG&E's proposals violate DRA's proposed modified additive price floor ("MAPF"). Margins above the MAPF are shown in Appendix H; Tables H-4 and H-5 show the violated MAPF constraints. In Appendix G, Tables G-6 and G-7 show the CTMs for the reduced discounts as adjusted to conform to the MAPF. In certain cases, because the discounts are reduced in Tables G-6 and G-7, the CTMs are higher than the corresponding CTMs in Tables G-4 and G-5. The corresponding cases in Table H-6 show a zero margin, indicating that the MAPF is constraining the discount. In cases where the full 12% Standard EDR cannot be granted due to the MAPF constraint, Tables G-7 and H-7 show "n/a", indicating that an Enhanced Option discount is unavailable.

cost modifications described above. They also include marginal distribution costs for constrained areas where there is no excess distribution capacity.

Table 2-5: DRA Proposed Floor Prices for Bundled Service EDR Contracts

Floor Prices for Bundled Services						
	NBC Floor		Marginal Cost Floor		Modified Additive Floor	
	Floor Price	Max Discount	Floor Price	Max Discount	Floor Price	Max Discount
E-20T	0.03165	65.6%	0.06779	26.3%	0.06942	24.5%
E-20P	0.03271	71.7%	0.08535	26.2%	0.08694	24.8%
E-20S	0.03466	72.7%	0.09004	29.1%	0.09119	28.2%
E-19P	0.03469	72.8%	0.09203	27.9%	0.09353	26.7%
E-19S	0.03561	74.3%	0.09795	29.4%	0.09750	29.7%
A-10S	0.03996	74.1%	0.10614	31.2%	0.10439	32.3%

Inspection of Table 2-5 shows that DRA's proposed NBC floor would not prevent PG&E's proposed 35% Enhanced EDR discount. But DRA's proposed Marginal Cost Floor and Modified Additive Floor would prevent granting the full 35% discount over a 5-year contract term.

As discussed, however, DRA proposes to apply the latter two price floors only as a 5-year net present value ("NPV"), and not on a year-by-year basis. This allows for a variable (declining) discount percentage, and permits the marginal cost and modified additive price floors to be violated in the initial years, as long as revenues exceed the pricing floors on a 5-year NPV basis. DRA's EDR pricing proposals are described below.

4. DRA's Proposed EDR Price Floors for Direct Access and CCA Customers

DRA's proposed pricing floors for DA and CCA customers are shown in Tables 2-6 and 2-7. DRA's proposed EDR floor prices, like the current EDR floor prices, are more constraining for DA and CCA customers than they are for bundled service customers. For DA and CCA customers, all rate components, with the sole exception of Distribution, are nondiscountable. Because the feasible discounts are severely limited in some cases for DA and CCA customers in constrained areas, DRA shows the unconstrained area floor prices separately, in Table 2-7.

Table 2-6: DRA Proposed Floor Prices for DA and CCA EDR Customers

Floor Prices for DA/CCA Customers in Constrained Areas						
	NBC Floor		Marginal Cost Floor		Modified Additive Floor	
	Floor Price	Max Discount	Floor Price	Max Discount	Floor Price	Max Discount
E-20T	0.03334	5.5%	0.01590	54.9%	0.03415	3.2%
E-20P	0.03415	36.0%	0.03031	43.2%	0.05029	5.7%
E-20S	0.03745	41.8%	0.03180	50.6%	0.05429	15.7%
E-19P	0.03871	39.8%	0.03575	44.4%	0.05925	7.8%
E-19S	0.03857	45.7%	0.03725	47.5%	0.06060	14.6%
A-10S	0.04629	45.8%	0.04223	50.5%	0.07037	17.6%

For DA/CCA rate schedules other than E-20T, distribution comprises at least 35% of the full tariff revenue, and therefore a 35% discount would be achievable consistent with the NBC price floor. For E-20T, however, 94.5% of the revenue from DA/CCA customers is nondiscountable, allowing at most a 5.5% discount for such customers assuming the distribution rate were discounted to zero.

Table 2-6 shows that the marginal cost floor is not constraining for DA/CCA customers, but the modified additive price floor further constrains discounts available to DA/CCA customers when marginal distribution costs for constrained areas are used. Table 2-7 shows that the marginal costs for unconstrained areas would allow much higher discounts, based on DRA's modified additive price floor, except for Schedule E20T. Based on this analysis, DRA presents its EDR discount proposals for DA and CCA customers in Section V below.

Table 2-7: DRA Proposed Floor Prices for DA and CCA EDR Customers

Floor Prices for DA/CCA Customers in Unconstrained Areas						
-	NBC Floor		Marginal Cost Floor		Modified Additive Floor	
-	Floor Price	Max Discount	Floor Price	Max Discount	Floor Price	Max Discount
E-20T	0.03334	5.5%	0.01590	54.9%	0.03415	3.2%
E-20P	0.03415	36.0%	0.01525	71.4%	0.03522	34.0%
E-20S	0.03745	41.8%	0.01647	74.4%	0.03896	39.5%
E-19P	0.03871	39.8%	0.01872	70.9%	0.04222	34.3%
E-19S	0.03857	45.7%	0.01928	72.8%	0.04262	39.9%
A-10S	0.04629	45.8%	0.02189	74.4%	0.05003	41.4%

III. RATE DESIGN PRINCIPLES FOR DISCOUNTED DISTRIBUTION AND GENERATION RATES

As discussed above, only distribution and generation can be discounted; all other rate components are nondiscountable.

A. PG&E'S DISCOUNTED RATES PROPOSAL

PG&E proposes to discount only distribution, and proposes a negative distribution rate as necessary to achieve its proposed 12% or 35% total discounts. DRA strongly disagrees that a negative distribution rate is consistent with sound public policy, in the context of an EDR.

B. A NEGATIVE DISTRIBUTION RATE WOULD DISCOUNT NONDISCOUNTABLE RATE COMPONENTS FOR DA AND CCA CUSTOMERS, AND MUST NOT BE PERMITTED FOR SUCH CUSTOMERS

As stated above, for DA and CCA customers, all rate components, with the sole exception of Distribution, are nondiscountable. A negative distribution rate means, therefore, that the total revenue from such a customer would be insufficient to cover the total of that customer's nondiscountable rate components. This would result in effectively discounting one or more nondiscountable rate components; a logical contradiction. There is no other reasonable interpretation. PG&E states that nonbypassable rate components would be fully funded[75]; this cannot be true for DA/CCA customers paying a negative distribution rate.

C. DISTRIBUTION RATES SHOULD BE IDENTICAL FOR SIMILARLY SITUATED DA, CCA, AND BUNDLED SERVICE CUSTOMERS

PG&E has proposed to discount distribution rates more deeply to bundled service customers than to DA or CCA customers within a given rate schedule. DRA disagrees with this proposal. There is no difference in the distribution services provided to DA or CCA and bundled service customers. Nor has PG&E alleged any differences in the cost of providing distribution services between these customer subgroups. Therefore it

[75] PG&E, A.12-03-001, March 1, 2012, p.3-2.

appears that PG&E's proposal violates a fundamental principle of competitive neutrality and should be rejected.

DRA has not reached a conclusion as to whether unequal distribution rates are legally permissible without a cost basis. But it recommends, based on the based policy grounds of competitive neutrality, that distribution rates, with or without EDR discounts, be equal for DA/CCA and bundled service customers within the same rate schedule.

D. A NEGATIVE DISTRIBUTION RATE MUST NOT BE ALLOWED FOR ANY CUSTOMERS

DRA has argued above that negative distribution rates implicitly would discount nondiscountable costs for DA/CCA customers and are therefore not permissible for such customers. However, given the need for competitive neutrality in distribution rates, discussed above, negative distribution rates should not be allowed for ***any*** customer, DA, CCA, or bundled service.

E. DISTRIBUTION RATES SHOULD NOT BE DISCOUNTED BELOW MARGINAL COST

DRA's Modified Additive Price Floor for DA/CCA customers is the sum of NBCs plus the distribution marginal cost. Application of this pricing floor means that DA/CCA customer distribution rates cannot be discounted below the marginal distribution cost. DRA's competitive neutrality principle means that the same floor would apply to bundled service customers: distribution rates should not be discounted below marginal cost for ***any*** customer, DA, CCA, or bundled service.

F. GENERATION RATES CAN BE DISCOUNTED

While PG&E has not proposed to discount Generation rates, DRA is unaware of any legal prohibition or Commission policy that would prevent such a discount. DRA's proposed discounted EDR rates would first discount Distribution down to a marginal cost floor; additional discounts would be taken from the Generation rate, if warranted and consistent with DRA's threefold EDR pricing floors.

In some cases, Generation rates would be allowed to go below marginal cost in the initial years of an EDR contract. However, the Generation rate must exceed the Generation marginal cost on a present value basis over the 5-year contract term.

Pricing proposals for bundled service customers are discussed in the next section.

IV. DRA'S EDR DISCOUNT PROPOSALS FOR BUNDLED SERVICE CUSTOMERS

A. STANDARD EDR OPTION

As PG&E noted, the current (unmodified) additive EDR price floor does not, in some cases, allow the full Standard EDR 12% discount. DRA's analysis indicates that the current additive price floor, with updated marginal costs, would continue to constrain Standard Option discounts in some cases. As shown in Table 2-5, DRA's proposed floor prices would allow the full 12% Standard EDR option discount for all eligible bundled service customers in the six rate schedules proposed by PG&E.

B. ENHANCED EDR OPTION

As noted above, PG&E's proposed 35% Enhanced EDR discount would violate both the Marginal Cost Floor and the Modified Additive Price Floor. However, DRA proposes to apply both floors on a 5-year present value basis, rather than year-by-year (as with the current EDR program). DRA's pricing floors would thus allow a 35% discount in the initial year of a 5-year contract term, provided discounts decline over time such that the appropriate pricing floors are respected on a 5-year NPV basis.

DRA accordingly proposes a discount which declines over time, according to the following schedule: 35% in year 1, 30% in year 2; 20% in year 3, 15% in year 4; and 10% in year 5. The average discount under DRA's proposal would be 22%, which, unlike PG&E's proposal, would produce positive CTMs both at 5 years and at 10 years (on an ex ante basis); and thus would adhere to all three of DRA's proposed EDR floor prices.

DRA's declining Enhanced EDR proposal is similar to a previously adopted 25-20-15-10-5% declining discount. Further, DRA's proposal averts a significant problem posed by PG&E's flat 35% discount, which is that at the end of an Enhanced EDR contract, customers would face a nearly 50% rate increase.[76]! DRA's proposed EDR rates for bundled service customers are shown in Appendix I.

V. DRA'S EDR DISCOUNT PROPOSALS FOR DIRECT ACCESS AND CCA CUSTOMERS

A. Standard EDR Option

DRA's proposed floor prices allow the proposed 12% Standard EDR Option discount for DA and CCA customers in rate schedules E-20S, E-19S, and A-10S, as well as for E-20P and E-19P customers located in unconstrained areas. However, as shown in Table 2-6, a 12% discount would violate DRA's modified additive price floor for other DA or CCA customers located in constrained areas. Therefore, for constrained area DA and CCA customers in rate schedules E-20T, E-20P, and E-19P, discounts should not exceed 3.2%, 5.7%, or 7.8%, respectively.

B. Enhanced EDR Option for Customers in Unconstrained Areas

With the exception of DA and CCA customers in rate schedule E-20T, eligible customers in unconstrained areas of high-unemployment counties would qualify for the same DRA proposed Enhanced EDR discount for bundled service customers, which declines over time, according to the following schedule: 35% in year 1, 30% in year 2; 20% in year 3, 15% in year 4; and 10% in year 5. This discount scheme, which averages 22% over the proposed 5-year contact term, is consistent with the unconstrained area floor prices shown in Table 2-7.

C. Modified Enhanced EDR Option for DA and CCA Customers in Constrained Areas: Rate Schedules E-20S, E-19S, and A-10S, Only

As shown in Table 2-6, such customers cannot qualify for DRA's proposed 35-30-20-15-10 decreasing discount Enhanced EDR program, because the average 22% discount would violate the modified additive floor price. DRA proposes a Modified

[76] 50% ≈ 1/(1 – 35%)

Enhanced EDR Option for such customers, with a declining discount schedule of 20% in year 1, 15% in years 2 and 3, and 10% in years 4 and 5.

As noted above, DA and CCA customers located in constrained areas and taking service in rate schedules E-20T, E-20P, and E-19P cannot qualify for the full 12% Standard Option EDR discount and so would not be offered an Enhanced EDR option.

VI. CONCLUSION

The Commission should adopt DRA's proposed EDR price floors and rate discounts, which are carefully crafted to protect ratepayers from undue risk while offering meaningful discounts to "at risk" customers.

CHAPTER 3 – EDR ELIGIBILITY, RATEPAYER PROTECTION, AND FUNDING

(Witness – Elise Torres)

I. INTRODUCTION

DRA supports a program of carefully targeted and crafted economic development rates aimed at businesses which truly demonstrate a hardship, and which are at risk of leaving California or would not otherwise locate in California. The EDR program offers short term electric rate relief to some businesses during California's current economic situation as well as a tool to attract new businesses to locate in state. DRA's proposed safeguards are intended to help limit the costs of an EDR program and to lower the risk for non-participating ratepayers. The Commission should adopt the following recommendations in order to ensure that ratepayers benefit from the EDR program as required by statute.[77]

II. THE EDR PROGRAM SHOULD INCLUDE MORE PROTECTIONS FOR NON-PARTICIPATING RATEPAYERS

PG&E is proposing to expand its EDR program extensively, which makes the need for non-participating ratepayers protections paramount. One potential danger for non-participating ratepayers is the threat of free-ridership, which could increase costs for non-participating ratepayers without offsetting benefits. The current EDR program has a number of requirements for eligibility, intended as safeguards against free-riders. PG&E proposes to weaken or eliminate some of those restrictions. Specifically, PG&E proposes to remove the following safeguards: third party review and approval of customer applications, the requirement that electricity costs constitute a threshold percentage of the customer's operating costs, and the liquidated damages provision for premature withdrawal. DRA opposes PG&E's proposed EDR eligibility changes, and recommends that the Commission tighten the eligibility criteria and oversight process for participation in the EDR program in order to limit the number of potential free-riders.[78]

[77] P.U. Code 740.4 (h).
[78] In reference to Scoping Memo Issue #23.

Another non-participating ratepayer issue is that EDR program participants could prematurely leave the state before the end of the 5-year EDR program term. DRA recommends changes to the EDR program contract, which will discourage premature departure of participants and protect non-participating ratepayers. The following sections discuss the issues that the EDR program raises for non-participating ratepayers and implementation measures that should be incorporated into the EDR program to guard against these risks.

A. PROVISIONS OF THE CUSTOMER AFFIDAVIT AND CONTRACT SHOULD BE MODIFIED

DRA believes that better safeguards are needed to discourage free-riders and ensure ratepayer benefits. Under the EDR program, participants will receive large discounts and significant cost savings. The customer affidavit and contract are the only tangible accountability mechanisms for customers in the EDR program. The affidavit requires that the signer, under penalty of perjury, attest that "but for this rate, the business would not expand, stay in, or come to California."[79]

The requirement that the affidavit be signed under the penalty of perjury is important to retain in order to protect the integrity of the EDR program.[80] Considering that the affidavit is the only tool to directly discourage free-riders who would otherwise receive an unjustified sizable discount, signing the affidavit under penalty of perjury is not overly burdensome and the requirement should be retained. Changes also should be made to the affidavit and contract between EDR participants and PG&E in order to limit the risk to non-participating ratepayers, which will be discussed below.

1. The EDR customer affidavit should include a provision that electricity costs constitute at least 5% of the customer's operating expenses.

DRA believes that potential EDR customers should be required to demonstrate that electricity makes up a threshold percentage of their operating costs in order to qualify

[79] A 12-03-001, PG&E Prepared Testimony, Chapter 3, Attachment A, P. 5.
[80] This paragraph addresses Scoping Memo Issue #20.

for the EDR discount.[81] The affidavit should contain the following provision for retention customers, "On an annual basis, the cost of electricity for [Company Name] at this facility represents at least 5% of operating costs, less the cost of raw materials." For attraction and expansion customers, a similar provision also should be included in the affidavit, though it should acknowledge that the percentage of operating costs is an estimate, but it should still account for at least 5%. This affidavit provision has been included in past EDR programs.[82]

The inclusion of this provision in the affidavit will guard against free-riders because it provides a measurable benchmark for eligibility. As of March, 2012, PG&E had 815 customers who potentially could apply for the enhanced EDR program based on size and location alone, which emphasizes the need to limit eligibility.[83] The Commission has adopted a 5% threshold in prior EDR proceedings.[84] Accordingly, maintaining this provision will ensure the integrity of the program by making it only available to customers for whom energy costs will have a meaningful impact on their decisions. The Commission should require the addition of this provision to the customer affidavit in order to discourage free-ridership and to ensure that the discount is only available to those customers for whom energy is a material cost.

2. The enhanced EDR program should not allow participating customers to renew their enhanced EDR contracts for a second 5-year term

PG&E proposes to allow standard and enhanced EDR customers to reapply or the EDR program once, for a second 5-year term. This proposal, especially in regard to enhanced EDR customers, creates an excessive amount of non-participating ratepayer risk.[85] In response to a data request, PG&E provided a 10-year net present value of the CTM calculation for standard and enhanced EDR customers who renew their contracts

[81] The following section addresses Scoping Memo Issue #19.
[82] D 05-09-018; D 10-06-015.
[83] PG&E Response to TURN Data Request 2, Question 1.b. In March, 2012, there were 815 PG&E customers in the Enhanced-EDR eligible counties taking service on the commercial and industrial rate schedules with a load of at least 200 kW.
[84] D 05-09-018, p.23; D 10-06-015, p.7.

and participate in the program for 10 years. According to PG&E's calculations, if an enhanced EDR customer in a constrained area renews its contract for an additional 5 years, the 10-year present value CTM for this contract will range from negative $382,466 to negative $7,938, depending on which rate schedule the customer is on.[86] Under PG&E's proposal, non-participating ratepayers will pay for this negative CTM.

DRA proposes to allow standard and enhanced EDR customers to reapply for a second term in the ***standard*** EDR program, provided that they continue to meet the eligibility requirements and sign another customer affidavit and contract. This proposal will reduce ratepayer risk to an acceptable level because standard EDR customers, in a constrained area, who renew their contracts for a second 5-year term, will yield a positive CTM range of $210,201 to $1,497,750 after 10 years, depending on which rate schedule the customer is on.[87] Enhanced EDR customers in a constrained area, who reapply for a second term on the standard EDR program, will also produce a positive 10-year CTM ranging from $81,378 to $488,406, depending on which rate schedule the customer is on.[88] The Commission should require that only the standard EDR discount be available to all EDR customers reapplying for a second term in the program.

3. The EDR contract should include a non-assignment clause

EDR contracts should not be assignable in the event an EDR customer company is sold because it creates opportunities for free-riders. PG&E proposes to allow for the assignment of an EDR contract "only if PG&E consents in writing and the party to whom the agreement is assigned agrees in writing to be bound by the EDR agreement in all

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[85] The following section addresses Scoping Memo Issue #22.

[86] PG&E's Response to DRA Data Request 02, Question 5 ; See, Appendix E. DRA used PG&E's Marginal Cost in these calculations.

[87] These numbers are based on PG&E's response to DRA's Data Request #2, Question 5 for rate schedule E-19s. See, Appendix E. DRA applied PG&E's calculation method to generate these numbers for all the EDR rate schedules. DRA used PG&E's Marginal Cost in these calculations. *Under DRA's somewhat more conservative marginal cost assumptions, the CTMs range from $1,268,201 to $181,916.*

[88] These numbers are based on PG&E's response to DRA's Data Request #2, Question 5. See, Appendix E. DRA applied PG&E's calculation method to generate these numbers for all the EDR rate schedules DRA used PG&E's Marginal Cost in these calculations. *Under DRA's somewhat more conservative marginal cost assumptions, the CTMs range from $258,857 t0 $37,295.*

respects."[89] PG&E's proposal does not sufficiently guard against free-riders because it removes the eligibility oversight measures required in the initial application. DRA proposes to include a non-assignment clause in the EDR contract. The Commission should require the purchasers of an EDR customer company to reapply for the EDR program and re-sign the customer affidavit.

B. EDR Program Applications Should be Reviewed by an Independent Third Party

EDR customer applications should be reviewed by an independent third party such as California Business Investment Services ("CalBIS") in order to guard against free-riders and to limit risks to non-participating ratepayers.[90] Past EDR decisions[91] have required independent third party review and determined that CalBIS is the appropriate state agency to conduct third party review of EDR customer applications. PG&E has an interest in signing up as many EDR customers as possible because it will grow or maintain its market share, which highlights the need for independent third party review. Moreover, under PG&E's proposal, which lacks a shareholder participation component, it has little at stake if it mistakenly grants an EDR contract where none was warranted. In Decision 05-09-018, the Commission stated, "it is clear that CalBIS has the expertise and staff to identify and screen legitimate economic development candidates."[92] CalBIS is the State's preeminent evaluator of economic development issues,[93] which is another reason that it is the appropriate third party to conduct review of EDR customer applications.

PG&E proposes to remove CalBIS' third party approval authority because it "has proven to be redundant in the approval process, with PG&E and CalBIS performing similar but separate evaluations."[94] On July 13, 2012, DRA discussed the EDR application review process with the Deputy Director of CalBIS, Mather Kearney, and two Senior Business Development Specialists, Jason Rancadore and Patrick McGuire. The

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[89] A 12-03-001, PG&E Prepared Testimony, Chapter 3, Attachment A, P. 3.
[90] The following section addresses Scoping Memo Issue #17.
[91] D 05-09-018, p.25; D 10-06-015, p.7.
[92] D 05-09-018, p. 18.
[93] *Ibid at 19.*
[94] A 12-03-001, PG&E Prepared Testimony, Chapter 2, P. 2-5.

CalBIS representatives explained their EDR application review process and said that it takes 3-5 days.[95] They felt their review was more in-depth and thorough than PG&E's review, which was highlighted in the "EDR Business Case Evaluation" form[96] they use in their review.[97] CalBIS also stressed that their knowledge of other states' economic development incentives makes them more qualified to evaluate applications and confirm that applicants have truly explored out of state options.[98] For these reasons, DRA recommends that the Commission follow past EDR decision precedent and require CalBIS review and approval of all EDR customer applications.

C. THE COMMISSION SHOULD REQUIRE PG&E TO SUBMIT ANNUAL REPORTS ON THE EDR PROGRAM TO THE COMMISSION

In decision 05-09-018, the Commission required PG&E to submit annual reports to the Commission about the EDR program including a listing of all EDR applicants; the contents of the CalBIS review for these applicants; and the utilities final selection of EDR candidates.[99] In Decision 10-06-015 the Commission ordered additional information to be included in the Annual Reports, including a detailed process flow chart describing the Utilities' EDR screening and enrollment processes, and for new EDR customers who have commenced operation under an EDR contract, the amount paid to the utility above the Floor Bill or Floor Price and the discount provided relative to the customer's OAT (defined as the difference between the OAT and the discount rate).[100] The Commission should continue to require PG&E to file Annual Reports containing annual and cumulative CTM and discount data by contract and EDR portfolio total. CTMs should be reported both on an ex ante and ex post basis. The Commission should also consider requiring PG&E to submit annually or every other year, an ex-post assessment of how many jobs were created or retained by the program in the Annual Reports.[101]

[95] DRA phone interview with Elise Torres of DRA and Mather Kearney, Jason Rancadore, & Patrick McGuire of CalBIS. July 13, 2012.
[96] A blank copy is located in Appendix C for reference.
[97] DRA phone interview with Mather Kearney, Jason Rancadore, & Patrick McGuire. July 13, 2012.
[98] *Ibid.*
[99] D 05-09-018, p.28, Order #2.
[100] D 10-06-015, p.8.
[101] This section addresses Scoping Memo Issue #33.

D. The EDR Program should have an Enrollment Cap

DRA recommends that the Commission retain the participation cap required in the current EDR program.[102] DRA recommends that a cap be placed on the level of participation in the EDR program. DRA believes that a participation cap on the program will limit risk for non-participating ratepayers. PG&E's existing schedule ED has a cap on participation of 200 MW, and as of January 1, 2012, the schedule ED program had 34.2 MW enrolled.[103]

PG&E proposes to remove the participation cap. Yet, the participation cap should be retained because the proposed new EDR program would offer a much larger discount than past programs, which is could result in a large spike in applications. According to PG&E's most recent customer data, it currently has 3,820 commercial and industrial customers with a load of at least 200 kW.[104] Moreover, the average participant in the current program is 2.3 MW in size.[105] PG&E is unable to provide a forecast of how many customers will enroll in the EDR program.[106] But clearly, if a significant number of the 3,820 customers sign up, the cumulative enrollment could exceed to current 200 MW cap by multiple times. DRA recommends setting a cap on total EDR program participation, including both the standard and enhanced program, of 200 MW.

E. PG&E Should Conduct an Energy Audit of EDR Program Applicants and Discuss Cost-Effective Conservation and Load Management Measures with Applicants

A past EDR program required PG&E to conduct an energy audit of all EDR applicants and present to these applicants all cost effective energy efficiency and demand side management programs that have a 5-year or less pay-back period.[107] DRA recommends that this requirement be retained and encourages the Commission to

[102] The following section addresses Scoping Memo Issue #16.
[103] Merced Irrigation District and Modesto Irrigation District Data Request Response 2, question 02. See, Appendix E.
[104] TURN Data Request Response 2, question 01. See, Appendix E.
[105] The current program has 15 participants with a cumulative load of 34.2 MW, which equates to 2.3 MW each.
[106] Merced Irrigation District and Modesto Irrigation District Data Request Response 1, question 12 & 13. See, Appendix E.

consider requiring EDR customers to implement cost effective energy efficiency and demand side management programs that have a 2-year pay-back period.[108] This recommendation will help the Commission achieve its Total Electricity and Natural Gas Program Savings Goals.[109] Requiring EDR customers to implement measures with a 2-year bay-back period will also create savings that persist beyond the EDR contract period, which increases the potential that an EDR company will stay in business after the term of the EDR contract has run.

The Commission has also stated, "the utilities should make every conceivable effort to persuade EDR customers to meet the Commissions identified conservation and efficiency objectives."[110] The Commission explained that it would not require EDR applicants to assume the necessary costs of participating in structured energy efficiency or conservation programs because these customers were facing difficult financial constraints.[111] The Commissions rationale in Decision 05-09-018 is supported by the fact that EDR customers in that program were receiving an initial 25% discount that declined 5% each year for 5 years.[112] Under PG&E's proposed enhanced EDR program, customers will receive a 35% discount. This is a sizable discount and the Commission should consider requiring enhanced EDR customers to use a portion of these significant savings to implement cost effective energy efficiency and demand side management programs that have a 2-year pay-back period.

F. PENALTIES FOR CUSTOMER EARLY TERMINATION – LIQUIDATED DAMAGES

DRA recommends that the Commission require PG&E to include a liquidated damages clause in its customer contract that specifies that the EDR discounts should be paid back if customers terminate service prior to the full contract period, except in cases of business closure or load reduction without relocation. PG&E's new EDR contract

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[107] D 05-09-018, p.16.
[108] This section addresses Scoping Memo Issue #18.
[109] R. 01-08-028, Table 1E.
[110] D 05-09-018, p.15.
[111] D 05-09-018, p.16.
[112] *Ibid*., p.2.

proposal contains a "Termination of Agreement" clause that requires 30 days written notice from the customer but does not include any penalties for early termination.[113] The new contract proposal does contain a liquidated damages clause, but it only applies to termination due to Applicant's misrepresentation or fraud.[114]

DRA recommends including an additional provision to PG&E's proposed liquidated damages clause that would cover situations in which the customer terminates service prior to the full contract period. The provision uses the following language from the liquated damages clause established by the Commission in Decision 05-09-018:

> "*For other cases of early termination (excepting business closure or reduction of load without relocation), liquidated damages equal to the cumulative differences between (i) the bills calculated under the ED rate to the date of termination and (ii) bills calculated under the OAT*."[115]

Inclusion of this provision in the EDR contract is necessary to protect non-participating ratepayers and deter free-riders.

Without this provision, a customer could take advantage of the higher discounts and then cease taking service before the full term of the contract. PG&E's CTM analysis is based on a customer maintaining PG&E service for 10 years, and early termination of EDR contracts invalidates the conclusions of PG&E's CTM analysis.[116] While DRA's more stringent proposal requires a positive net present value of CTM over the 5-year contract term, premature customer departure could result in a negative CTM and shift costs to nonparticipating ratepayers, if either DRA's or PG&E's proposals were adopted. For these reasons, the Commission should require the inclusion of a liquated damages clause for early termination of an EDR contract.

G. Funding the cost of EDR

DRA recommends that the Commission require PG&E shareholders to pay for 25% of the EDR discounts if DRA's proposed floor price is adopted. If PG&E's

[113] A 12-03-001, PG&E Prepared Testimony, Chapter 3, Attachment A, P. 3.
[114] *Ibid.*
[115] D 05-09-018, p. 24.
[116] A 12-03-001, PG&E Prepared Testimony, Chapter 3, P. 3-3.

proposal to not include a floor price is adopted, DRA recommends the Commission require shareholders to pay for 50% of the EDR discounts. In addition, PG&E shareholders should pay for 100% of any negative CTM, on an aggregate EDR program basis, that might remain after 10 years. DRA believes that requiring PG&E to share the costs of this discount will provide the utility with a strong incentive to limit discounts to the intended target participants and, as a result, reduce free-ridership. The fact that PG&E shareholders derive benefits from these discounts serves as an additional reason for sharing such costs. Requiring shareholders to cover any negative CTM at the end of 10 years assures compliance with the ratepayer benefits provision of PU Code § 740.4(h).

PG&E shareholders will benefit from the EDR program because it will attract new customers to PG&E and help retain current customers. This is why PG&E representatives are working in this proceeding– to secure the long term interests of their shareholders by helping maintain the customer base and thus the long term economic health of the company. Trends in sales and revenues affect the recommendations made by market analysts about the company, which in turn affects the stock price. For example, Reuters stock quote page for PG&E states the number of PG&E customers in the first paragraph of its discussion of the company and also mentions that PG&E's revenues are generated mainly through the sale and delivery of electricity and natural gas to customers.[117] This shows that the size of a utilities customer base is an important financial strength indicator considered by market analysts. Utilities with stable or increasing sales and revenues will be perceived as financially healthy. Thus, retaining customers through EDR programs is beneficial to shareholders.

PG&E's annual reports to shareholders acknowledge the importance of the size of the company's customer base. In the 2011 Annual Report, Financial Highlights section, the first thing listed is PG&E's operating revenues.[118] Electric operating revenues are made up of "amounts charged to customers for electricity generation, transmission and

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[117] Reuters, Overview of PG&E Corp. Retrieved August 14, 2012, available at http://www.reuters.com/finance/stocks/overview?symbol=PCG.N. See, Appendix F

[118] PG&E 2011 Annual Report, p.1. See, Appendix D.

distribution services."[119] This indicates that PG&E considers its operating revenues to be paramount and PG&E's revenues are directly related to the number of customers it has. This further supports the assertion that PG&E financial results and shareholders are directly affected by the size of the Company's customer base.

Also, in PG&E's Securities and Exchange Commission ("SEC") filing for 2011, Exhibit 13-Management's Discussion & Analysis of Financial Conditions & Results of Operations, PG&E names the following as a "Risk Factor":

> *"PG&E Corporation's and the Utility's financial results can be affected by the loss of Utility customers and decreased new customer growth due to municipalization, an increase in the number of community choice aggregators, increasing levels of "direct access," and the development and integration of self-generation technologies."*[120]

PG&E's has filed two Quarterly Reports to the SEC in 2012. Both of these reports also discuss the loss of customers due to various forms of bypass and competition, including loss of generation revenue due to customers switching to DA and CCA providers, as factors that could affect PG&E's future financial situation.[121] The above references to PG&E's SEC filings indicate that PG&E considers customer loss as a risk to its financial condition, therefore gaining or retaining customers would benefit its financial condition and subsequently its shareholders.

Furthermore, PG&E seems to be concerned and has taken action in situations where it perceived the potential for losing some of its customer base. Threats to PG&E's customer base come from municipalization, annexation of portions of PG&E's service area by another utility, the formation of CCAs, as well as the loss of the industrial and commercial customers that is the subject of this proceeding. PG&E certainly does not seem indifferent to these circumstances. Indeed, DRA has observed that PG&E has taken

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[119] *Ibid.*, p. 10.
[120] Thomson Reuters, "PGECORP 10-K, Annual report pursuant to section 13 and 15(d) of the SEC Act of 1934, For the Fiscal Year Ended December 31, 2011." Filed on 2/16/2012, p.40. See, Appendix F.
[121] Thomson Reuters, "PGECORP 10-Q, Quarterly report pursuant to section 13 and 15(d) of the SEC Act of 1934, For the quarterly period ended March 31, 2012." Filed on 3/31/2012, p.42; Thomson Reuters, "PGECORP 10-Q, Quarterly report pursuant to section 13 and 15(d) of the SEC Act of 1934,
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action to try to prevent these events and the associated loss of customers. For example, PG&E shareholders spent $28 million[122] to sponsor Proposition 16, a ballot initiative in June 2010 that, if it had passed, would have required a two-thirds vote of the electorate before a public agency could create a CCA.[123] PG&E also spent $11 million to launch an initiative campaign to prevent Yolo County residents from designating the Sacramento Municipal Utilities District as their power company.[124] PG&E has consistently taken action to maintain its customer base; hence, DRA concludes that it is in PG&E's long-term interest in continuing to do so.

PG&E shareholders will also benefit from the EDR program because it will improve PG&E's corporate image and credibility by showing that it cares about its customers and the state of California. In Moody's Credit Evaluation Guidelines, it discusses the criteria used to establish PG&E's credit rating, including a discussion of seven "Ratings Divers." One of these divers is titled "New management focused on credibility issues."[125] Moody's also labels PG&E's credibility as an "important factor"[126] in its discussion of detailed rating considerations. Moody's also recognizes California's improving economy as a "Rating Diver"[127] and discusses job growth in California.[128] This shows a direct correlation between PG&E's corporate image and the number of jobs in California with PG&E's credit rating. Having a good credit rating benefits PG&E's shareholders because it makes the company appear financially strong which increases stock prices.

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For the quarterly period ended June 30, 2012." Filed on 8/7/2012, p.45. See, Appendix F.

[122] *Santa Cruz Sentinel*, "Prop 16 is June's priciest ballot initiative, with PG&E coughing up big money," March 25, 2010. See, Appendix F.

[123] Ballotpedia, California Proposition 16, Supermajority Vote Required to Create a Community Choice Aggregator, June 2010. Retrieved August 14, 2012, from http://ballotpedia.org/wiki/index.php/California_Proposition_16,_Supermajority_Vote_Required_to_Create_a_Community_Choice_Aggregator_(June_2010)#cite_note-1. See, Appendix F.

[124] *The People's Vanguard of Davis,* "PG&E Trying to Make Fight for Public Power Nearly Impossible," July 24, 2009. See, Appendix F.

[125] Moody's Investors Service, Moody's Credit Evaluation Guidelines, August 2009. Appendix B, p.1-2. See, Appendix F.

[126] *Ibid.*, p. 4.

[127] *Ibid.*, p. 2.

[128] *Ibid.*, p. 4.

The Commission has acknowledged that utility shareholders accrue benefits from EDR programs in past Decisions and Resolutions. In Resolution E-3654, the Commission discussed specific benefits PG&E derives from the EDR program:

> "*PG&E gains strategic competitive advantages by attracting new customers and locking in sales over the long term due to the nature of the Schedule ED contract. Once PG&E begins serving the new customer it gains the additional advantage of having been the first competitor to establish a relationship with the customer, arguably making it easier to sell additional services and placing the burden on competitors to lure the customer away from their existing provider.*"[129]

Further, in Decision 07-09-016, the Commission found that the EDR program benefits shareholders:

> *"b.Do any of the benefits of retaining EDR customers accrue to shareholders? If so, how should this be considered when determining cost-shifting?*
>
> *In 2000, the Commission noted the strategic competitive advantages associated with attracting new customers. (Resolution E-3654, 2000 Cal. PUC LEXIS 420, Findings 14, 18, and 19.) EDR discounts benefit shareholders by maintaining or increasing customer base and market share. EDR price advantages assist utility efforts to compete for customers at the borders of their service territories, for example against irrigation districts that might serve existing utility customers. EDR discounts help promote alliances with local business communities, which could assist utility political efforts, for example opposition to municipalization initiatives. Shareholders as well as ratepayers obtain the benefits of the EDR customers. The consideration of benefits accruing to shareholders should result in some allocation of costs to the utility, but this record does not support a finding of a particular percent."*[130]

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[129] Resolution E-3654, p. 6.
[130] D.07-09-016 at p.27.

DRA shares the Commissions above stated beliefs that PG&E's shareholders benefit from maintaining PG&E's customer base and market share, and thus it is appropriate to allocate some of the cost of the discount to PG&E's shareholders.

1. PG&E Shareholders should pay for 25% of the economic development rate discounts if the Commission adopts DRA's price floor proposal. If the Commission adopts PG&E's proposal that does not include a price floor, PG&E Shareholders should have to pay for 50% of the EDR discounts

DRA recommends that shareholders be required to bear 25% of the cost of the EDR discounts, assuming that the Commission adopts a floor price on those discounts.[131] The Commission has the discretion to allocate all or some portion of the cost of the EDR discount to shareholders. This principle was affirmed in Decision 07-09-016, in which the Commission determined its discretion was dependent "on the facts of a particular application."[132] The Commission chose not to require shareholder funding in Decision 07-09-016, but it should in this application because the facts emphasize the need for shareholder contribution.

First, for the enhanced EDR program, PG&E proposes to offer a much larger discount than it ever has before, which creates more risk for non-participating ratepayers. Second, PG&E is proposing to remove a majority of the non-participating ratepayer safeguards the past EDR programs have required. While DRA opposes many of PG&E's proposals to relax ratepayer safeguards in the current EDR program, DRA acknowledges that there is a need to offer greater discounts, in some circumstances, than are available from the current EDR. Therefore, in Chapter 2, DRA has proposed a less stringent price floor than that required currently. DRA has also proposed to allow negative CTM in the initial years of a 5-year contract, a departure from current EDR practice. DRA's proposed changes would increase ratepayer risk relative to the current EDR program, though not nearly to the extent of the much greater risk imposed by PG&E's current proposals.

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[131] This section addresses Scoping Memo Issue #30.
[132] D 07-09-016, p. 27.

If implemented carefully, PG&E's proposals, modified as recommended by DRA, would provide benefits relative to the current EDR program, in terms of increased customer participation, and increased CTM. Because both ratepayers and shareholders stand to benefit from a successful EDR program;[133] both should share in the increased risk needed to achieve these benefits. Therefore, according to the facts of this application, the Commission should exercise its discretion by adopting DRA's proposed discounts, price floors, and eligibility requirements and requiring PG&E shareholders to fund 25% of the EDR discount.

In the alternative, if the Commission chooses to adopt PG&E's proposed discounts, eligibility requirements, and *no* price floor, it should require PG&E shareholders to fund *50%* of the EDR discount, in light of the much greater risk to ratepayers from the lack of ratepayer safeguards in PG&E's proposals. It also must adopt 100% shareholder funding of any negative CTM after 10 years as described below to maintain legal compliance with PU Code § 740.4(h).

2. To guard against increased ratepayer risk, PG&E Shareholders should be responsible for 100% of negative CTM after 10 years

DRA recommends that shareholders be required to bear the cost of the EDR rate differential if an ex-post review of the EDR program reveals that it has not resulted in benefits to ratepayers after 10 years.[134] This requirement should pose little risk to shareholders – if PG&E's positive 10-year CTM projections prove accurate. In fact, if DRA's proposed Enhanced EDR Option discounts are adopted, the 10-year positive CTMs will be even greater, making the risk to shareholders from a negative CTM almost negligible.

After the commencement of the EDR program, the Commission should require PG&E to track CTM for each EDR customer and for the EDR program portfolio on an annual basis. Any negative CTM generated from the EDR program should be tracked in a balancing account established for that purpose. Beginning at year 6 (2018), and each

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[133] As discussed above, positive CTM exerts downward pressure on rates; and sales and revenue growth exerts upward pressure on stock prices.

year thereafter through 2022, any negative CTM balance should be earmarked for shareholder funding and debited against ratepayer revenue. If, at any time between year 5 and year 10 after the commencement date of the EDR program, the cumulative CTM turns positive for the EDR portfolio, shareholders could then recover the negative CTM previously credited to ratepayers.

In the event that the EDR program portfolio does not yield a positive CTM after 10 years, PG&E shareholders would not be eligible to recover the funds in the balancing account. Shareholder funding of EDR program generated negative CTM is supported by PU Code §740.4(h), which allows for rate recovery of economic development programs cost only if "…the utility … demonstrates that the ratepayers of the public utility will derive a benefit from those programs." Ratepayer benefit under PU Code § 740.4(h) requires a positive CTM, as was established in Chapter 1, Section E (1) of this Testimony. Accordingly, if the EDR program results in a negative CTM, then ratepayers will not benefit from the program and costs from the program are not eligible for rate recovery.

If program costs cannot be recovered through rate recovery under PU Code § 740.4(h), then PG&E shareholders are responsible for funding the entire negative CTM. PG&E acknowledged this principle, "under circumstances where a utility was not able to demonstrate that ratepayers will derive a benefit from EDR programs, the Commission may have discretion to allocate all, or some portion, of a negative margin to shareholders."[135] Therefore, if PG&E is not able to show a ratepayer benefit in the form of a positive CTM within 10 years from the start of the EDR program, then the Commission should require PG&E shareholders to pay for 100% of the negative CTM.

Though shareholder funding of negative CTM was not adopted in the most recent EDR proceeding, it should be noted that negative CTM was not even possible under the EDR tariff language that was implemented pursuant to D.10-06-015. This tariff language

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[134] This section addresses Scoping Memo Issue #31.
[135] TURN Data Request Response 3, question 09. See, Appendix E.

provided that EDR participants' discounts would be trued up after the fact, if marginal costs changed, to assure that negative CTM did not occur. Moreover, the liquidated damages language that was used was much more stringent than what PG&E proposes in this proceeding. PG&E is proposing an entirely different EDR paradigm in this proceeding where non-participants rather than participants pay for any negative CTM. This new paradigm requires that PG&E shareholders, not non-participating ratepayers, pay for the negative CTM in order to assure compliance with the ratepayer benefit provision in PU Code § 740.4(h).

III. CONCLUSION

For the reasons explained above, the Commission should adopt the following DRA recommendations:

1. Require the EDR customer affidavit to include a provision that electricity costs constitute at least 5% of the customer's operating expenses.
2. Prohibit enhanced EDR customers from serving two 5-year terms on the enhanced EDR rate schedule. Allow enhanced and standard EDR customers to reapply for a second 5-year term on the standard EDR rate schedule.
3. Require a non-assignment clause to be included in the EDR contract.
4. Require review and approval by CalBIS of all EDR customer applications.
5. Require PG&E to submit annual reports on the EDR program to the Commission. Consider requiring an assessment of the number of jobs created by the EDR program to be included in the Annual Reports every year or every other year.
6. Impose an enrollment cap of 200 MW on the entire EDR program, including both the standard and enhanced programs.
7. Require PG&E to conduct an energy audit of EDR program applicants and discuss cost effective energy efficiency and demand side management programs. Consider requiring EDR customers to implement cost effective energy efficiency and demand side management measures with a 2-year pay-back period.
8. Require a liquidated damages clause to be included in the EDR program contract for customer initiated early termination of EDR contracts.
9. Require PG&E Shareholders to pay for 25% of the economic development rate discounts if the Commission adopts DRA's price floor proposal. If the Commission adopts PG&E's proposal to not include a price floor in the EDR program, require PG&E Shareholders to pay for 50% of the EDR discounts.

10. Require PG&E to track CTM on an annual basis for each EDR customer and for the program as a whole. If CTM does not turn positive after 10 years from the commencement of the program, shareholders are responsible for funding 100% of the negative CTM.